MEXICO:
BASIC LEGAL ASPECTS
OF DOING INTERNATIONAL BUSINESS

BY

SANTISTEVEAN ABOGADOS, S.C.

Homero 1804 - Suite 902
Col. Polanco - México D.F. 11570, MÉXICO
Tel. (52+55) 5557-1515 / 5557-1775
Fax. (52+55) 5395-8095 / 5395-7096
E-Mail: info@santistevan.com.mx

Web Page: www.santistevan.com.mx

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PREFACE

This Guide has been designed to assist, in a user friendly way, those contemplating investing, or doing business with or in Mexico. It is intended to provide general information on a number of topics frequently addressed by the local and international business communities.

The purpose of this Guide is to provide initial information and a road map to international companies and entrepreneurs who find investing and taking risks in Mexico a way to compete and expand their business market.

Although every effort has been taken to provide an accurate guide, it is not meant to be a substitute for case-specific legal and business consultation. In order to make favorable and accurate decisions, we recommend seeking proper counsel.

We live now in the era of knowledge and information, and the best business decisions are made with previous fact finding and good information. We hope that through this Guide we contribute to such purpose.

Mexico City, April 2005

INITIAL CONTACTS:

JORGE G. SANTISTEVAN

FAUSTA MATTEI-GENTILI

ESTHER ABURTO OLAGUE

Homero 1804 - Suite 902
Col. Polanco - México, DF 11570
MEXICO
Tel. (52+55) 5557-1515 / 5557-1775
Fax. (52+55) 5395-8095 / 5395-7096
E-Mail: info@santistevan.com.mx
Web Page: www.santistevan.com.mx
FIRM PRACTICE & PROFILE

Qualifications: Lawyers with the best formal education, admitted to practice and with professional experience both in Mexico and some in the U.S.A.

Our Clients: International and Mexican companies doing business in Mexico and in Latin America.

Service Goals: To always provide high quality, useful, and timely services.

Approach: We have a "Problem Solving Approach." We first understand the business needs and timing of our Clients, and then use in a methodical manner, legal instruments and creativity to provide legitimate, practical, and timely solutions.

Recognition: Our quality services are demonstrated by the long term retention of a large number of clients, who also have been successful in their own trades. The Firm is regarded in Mexico among the best corporate Law Firms.

Systems: We keep and update state of the art systems, and a high degree of organization, to efficiently deliver our services.

Coordination: To fulfill our client needs we collaborate with diverse law, management, and accounting firms worldwide and within Mexico.

Some areas of Practice: We have substantial experience and develop efficiency in several business areas, including: Corporate and Business Transactions; Foreign Investments; Joint Ventures; Mergers, Acquisitions and Restructurings; Project Financing and Secured Transactions; In-Bond and Import/Export Programs; Taxation; Immigration; Trademarks; Transfer of Technology; Franchising; Real Estate Acquisitions and Development; Telecommunications; Energy, Oil & Gas; Labor; and Tourism.

We are also experienced in Government Procurement, and Representation and Negotiation before all Government Agencies.

The following chapters delineate many of the rules, regulations and standards governing different aspects of doing business in Mexico, with which our Firm has experience.
SOME REPRESENTATIVE CLIENTS

Advanced Metallurgy, Inc. (Philadelphia, U.S.A.); Alberta Learning (Alberta Government, Canada); Alpla Plastics (Austria/Germany); American Apparel, Inc. (California, U.S.A.); Aslchem International, Inc. (British Columbia, Canada); Apparel Ventures, Inc. (California, U.S.A.); Autoliv ASP, Inc. (Michigan, U.S.A. & Sweden); Bausch & Lomb, Inc. (New York, U.S.A.); Bay West Paper Corporation (Wisconsin, U.S.A.); Bank of Louisville (Kentucky, U.S.A.); Cambridge Technology Partners, a Novell Subsidiary (Massachusetts & Florida, U.S.A.); Castillo Miranda/CroweChizek (Mexico, Illinois, U.S.A.); Chicago Sweeteners Incorporated (Illinois, U.S.A.); Citibank, N.A. (Taiwan); Coperion Corporation (New Jersey, U.S.A.); Custom Hardware Manufacturing, Inc. (Iowa, U.S.A.); Diehard Pty Ltd (Melbourne, Australia); E3 Corporation (Georgia, U.S.A.); Eastman Chemical Company (Tennessee, U.S.A.); E*TRADE Access (Virginia, U.S.A.); First Indiana Bank (Indiana, U.S.A.); Fila (Italy); Gambro Renal Products/Gambro Blood Testing Components (Sweden); General Fasteners Company (Michigan, U.S.A.); Glen Raven (North Carolina, U.S.A.); Griner Engineering, Inc. (Indiana, U.S.A.); Guardian Industries (Michigan, U.S.A.); Fremantle Productions/Pearson TV (Florida - New York, U.S.A. & UK); Heinz North America (Pennsylvania, U.S.A.); Huppert Engineering-USA (Michigan, U.S.A.); Intel Corporation (California, U.S.A.); International Consolidated Technologies World (Arizona, U.S.A.); Internet Security Systems, Inc. (Georgia, U.S.A.); Interplastic Corporation (Michigan, U.S.A.); JD Services, Inc. (Utah, U.S.A.); Laboratorios Darphin (France); Le Cirque Restaurant (New York & Nevada, U.S.A.); Honda Tsushin Kogyo Co. Ltd (Japan); Mark VII - Exel (Houston, U.S.A. & UK); MBL Services, Inc. (Illinois, U.S.A.); Metalllics Systems Co. LLP (Ohio, U.S.A.); Mi-Jack Products (Illinois, U.S.A.); Moda in Casa (Mexico); Morgan & Morgan (Panama); NorthPacific Group, Inc. (Oregon, U.S.A.); Nufarm, Inc./Agtrol International, Inc. (Houston, U.S.A.); Opportunity International (Arkansas, U.S.A.); Otepi Oil (Venezuela); Pacific Connections (California, U.S.A.); Palm Bay Wine Imports (Florida - New York, U.S.A.); Phoenix Security Systems (Georgia, U.S.A.); PMC Corporation (New Jersey, U.S.A.); Progress Rail Services Corporation (Alabama, U.S.A.); Railcar, Ltd. (Georgia, U.S.A.); Relco Engineers, Inc. (California, U.S.A.); Remedy Energy Services, Inc. (Alberta, Canada); Ritchie Bros. Auctioneers (Vancouver, Canada); Scientific Games, Inc. (New York & Atlanta, U.S.A.); Smith Group Incorporated (Michigan, U.S.A.); Spencer Stuart (Illinois, U.S.A.); Stanley Jones Corporation (Tennessee, U.S.A.); Technitrol, Inc. (Pennsylvania, U.S.A.); Tektronix, Inc. (Oregon, U.S.A.); Thomson Industries, Inc. (New York, U.S.A.); TravelGold México, S.A. de C.V. (México/Ontario, Canada); Quinorgan International (Spain); The Thermos Group (Illinois, U.S.A.); Tucson County (Arizona, U.S.A.); UBF Garantias & Seguros (Brazil).
SOME REFERENCES

Embassies of: United States of America, Canada, Great Britain, and Australia;

Trade Offices of most U.S. State Governments including, the States of Arizona, California, Florida, Iowa, Illinois, Indiana, North Carolina, Oklahoma, Oregon, Tennessee and Texas, among others; and

Trade Offices of Canadian Provinces, including, the Provinces of Alberta, British Columbia, Quebec, and Ontario in Mexico City, among others.
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I. INTRODUCTION.

Mexico, a leader in Latin America’s international business movement, has been at the forefront of the economic "apertura" (opening) that is sweeping through the region. The Mexican Government has enacted a series of reforms that have made the Mexican economy one of the most open economies world-wide.

The North American Free Trade Agreement ("NAFTA") has aided this process, giving investors from throughout the world both greater access to the Mexican economy and greater protection for their investments in Mexico, whether by association with Mexican companies or by the establishment of 100% foreign owned branches or subsidiaries in Mexico.

1. Brief Description of the Mexican Government and Constitution. Mexico is a federal, democratic, representative Republic divided into 31 States and a Federal District. Each State has its own Constitution based on the Federal one and is free to legislate in areas that the Federal Constitution does not expressly grant to the Federal Government. The Federal Government has three branches: (i) the Legislative, which is exercised through the Congress; (ii) the Executive, which is exercised through the President; and (iii) the Judicial, which is exercised through the Supreme, Circuit and District Courts.

2. The Civil Law System. Mexico has a civil law system based heavily on the ancient Romans and further developed by the post-medieval French and Spanish civil law systems. Unlike the common law system whereby much of the law is contained in uncodified judicial principles and doctrine, in Mexico all of the law is contained in various statutes, ensuing regulations and decrees; judicial interpretation is limited to the parties involved in a particular case.

Generally, the statutory law speaks for itself. Thus, the judge's duty is merely to apply the appropriate provisions and to reason deductively from the principles reflected in them, and rarely does he/she consult judicial precedence and custom to arrive at the proper ruling.

Another important distinction is that Mexico’s civil law system is divided into two principal areas: public and private law. The public law system regulates the relations between the government and individuals and/or other government entities. Under this system, the government can only act according to the powers expressly granted in the legal provisions. The private law system regulates the relations between individuals and entities. Under this system, individuals and entities can do everything which is not prohibited by the legal provisions.

3. Notarization, Registration and the Role of Notaries and Commercial Brokers. Unlike common law countries (i.e. the United States), public notaries and commercial brokers are an integral part of "doing business" in or with Mexico. Mexican notaries must be involved in many commercial and personal activities such as the formal execution of real estate related contracts, powers of attorney and wills. In addition, notaries and brokers handle a variety of corporate matters such as the formalization of the incorporation of companies, corporate resolutions and the registration of liens. Brokers have notarial-like authority, but are limited to commercial operations.
A. Notarization: In order to transact business in Mexico certain acts are required to be Certified through a Notary Public to be valid. The Notary has a government concession to verify and legitimize ("certify") that the acts performed are truly legal. For example, a Notary will intervene in: granting powers, incorporation of companies, acquisition of real estate, mortgages, and some pledges.

B. Public Registry: Once notarized, some of foregoing acts have to be further registered at the Public Registries of Commerce or of Property. Examples of submissions to the Registry of Commerce are, general powers of attorney granted by companies, and the incorporation of companies. Examples of submissions to the Registry of Property are, those related to private acts, such as real estate transactions and mortgages.

IV. Practice of Law in Mexico. Any person, including foreigners, may practice Mexican law in Mexico if he/she has a law degree issued by an accredited Mexican law school. Once a lawyer is licensed to practice by an accredited law school, he/she can practice in any jurisdiction in Mexico. However, foreign lawyers licensed abroad may not practice Mexican law in Mexico. Therefore, consulting with Mexican counsel when doing business in or with Mexico, is highly recommended.

II. THE "DOING BUSINESS" CONCEPT.

Doing business "with" Mexico suggests engaging in international trade directly from the home office. Doing business "in" Mexico suggests the additional step of establishing a physical presence in Mexico and regularly engaging in commercial activities. The primary purpose of doing business "with" Mexico is to avoid, or at least minimize, involvement with the Mexican tax system and other areas of regulation such as Mexican labor laws and the social security system. On the other hand, those foreigners who need to establish more of a presence in Mexico, may find that the additional business and geographic advantages of a permanent presence in Mexico outweigh the tax and regulatory burden.

III. DOING BUSINESS "WITH" MEXICO.

A foreign company can do business "with" Mexico from abroad in order to minimize the tax and regulatory consequences arising from the establishment of a permanent presence in Mexico. However, foreigners must be extremely careful to ensure that they do not create a "permanent establishment" in Mexico as Mexican tax law considers taxable the income derived by foreigners from such entities.

A foreign company doing business with Mexico from abroad has traditionally used four basic commercial vehicles: (1) appoint a sales agent in Mexico; (2) appoint a commission (sales) agent (commercial intermediary) for the promotion of its goods or services; (3) enter into an agreement with an independent distributor in Mexico; or (4) license technology (for example in a franchise operation).

1. Sales Agent. Is a non-Mexican agent of a foreign company performing business acts in Mexico in the name and on behalf of the foreign concern. Even though this scheme has the appearance of doing business from abroad, it actually is doing business in Mexico as explained below.

A. Immigration Requirements. The Immigration Act (Ley General de Población) is Mexico’s current Immigration Act (hereinafter "IA") and provides for the terms and conditions upon which foreigners may enter into and conduct business in Mexico.

Typically, a sales agent is classified as a non-immigrant and sub-classified as a "visitor". An initial stay period of six (6) months to one (1) year is granted, subject to up to four (4) additional extensions if the Visitor receives sufficient funds from abroad to cover his/her expenses.

A second sub-classification of non-immigrants, although not specifically provided for by the IA, is commonly known as the Business Visa. Mexican Consulates abroad may issue "Modified Tourist/Business Visas" for up to six (6)
months, although they are usually issued for a thirty (30) day duration, with the ability to enter and leave in Mexico on multiple occasions.

A third sub-classification is the FMN Visa. Under NAFTA, company officers and personnel from Canada and the United States can employ these Visas for intra company transfers. Employees can provide brief support to affiliates in other NAFTA countries performing executive and managerial duties. The Visa must be requested at the airport or onboard the plane. The term of the Visa is thirty (30) days.

A sales agent should not enter Mexican Territory as a tourist when the underlying purpose of his/her trip is to do business in Mexico (i.e. visit customers, take orders, engage in contract negotiations connected with the principal’s business activities in Mexico). Failure to comply with immigration provisions carries penalties ranging from a fine or deportation to a felony charge.

A more detailed description of the immigration rules in Mexico and under NAFTA is discussed below (Ch. IV, Section 8, Immigration).

B. Application of the Mexican Labor Law to Sales Agents. The Mexican labor legislation (the "Labor Law") applies to all labor relations performed within the Mexican Republic. Even if a company enters into labor agreements from abroad (i.e. the United States) for subordinate services which are to be performed within Mexico, the legal effects of acts and contracts will be governed by the Labor Law. This is true regardless of the fact that the employer resides outside of the Mexican Republic.

a. Consequences of the Application of the Labor Law. In Mexico, the Labor Law and other laws derived from it, such as the Social Security Law (Ley del Seguro Social) and the Workers Housing Fund Institute Law (Ley del Instituto del Fondo Nacional para la Vivienda de los Trabajadores) are applicable to both foreign Company and sales agent located in Mexico. These regulations cannot be waived. (For a detailed explanation on this, see below.)

b. Advice as to Relations with Individuals that Render Services in Mexico. From past experience with international companies doing business in Mexico, we recommend having an independent contractual relation with sales agents rendering services in Mexico.

C. Application of the Mexican Income Tax Law.

a. Salaries. The rule is that all salary payments for employees residing in Mexico will be subject to a graduated withholding tax from 0% to 30% depending on the amount of salary. This withholding tax will be reduced by 1% every year, until reaching a maximum of 28% in 2007. Beginning in 2006, two tax rates shall be implemented: 25% for monthly income below MexCy $208,333.00, and 29% (28% beginning in 2007) for monthly income above that figure. Additionally, all taxpayers will have the right to exempt annual income of MexCy $76,000 from their taxable income.

b. Non-Withholding by a Foreign Employer. Notwithstanding the foregoing, a non-resident company in Mexico which does not have a "permanent establishment" (as defined below) in Mexico, is exempted from the withholding and payment of taxes of its local resident employees. In this case, the local sales agent will be responsible for the calculation and monthly payment of the income tax on his/her salary. If such taxes are not paid to the Tax Authorities, only the local sales agent will be subject to surcharges and penalties.

However, this exemption will not apply when a foreign company has an employee in Mexico performing certain activities on its behalf, since this will result in such foreign company having a "permanent establishment" for tax purposes. An explanation of "permanent establishment" in Mexico follows.
c. Tax consequences - Permanent Establishment. If a foreign establishment or entity is found to have created a Permanent Establishment in Mexico, that entity is no longer doing business "with" Mexico, and will be considered as doing business "in" Mexico. This shift in categorization creates an entirely different tax scenario.

Title I, Article 2 of the Mexican Income Tax Law ("ITL" - - Ley del Impuesto sobre la Renta) defines "permanent establishment" as follows: "Any income-yielding place of business in which business activities are partially or completely performed, or where independent personal services are offered." Examples of "place of business" include, branches, agencies, offices, factories*, workshops, mines, quarries or any other site for the exploration, extraction or exploitation of natural resources.

*Before current taxing methods for "Maquiladoras" were in place, there was concern in the industry that they would be considered Permanent Establishments, and that double taxation would occur. Since 1999, as long as they: (i) comply with the rules for "Safe Harbor", "Value Plus Profit on Assets" or "Profit Margins plus Profits on Assets," and (ii) the Country of the resident from abroad ("Maquiladora's Client") has signed a Tax Treaty with Mexico, this issue is no longer a concern.

In addition, the foreigner, even without a place of business, will be considered as having created a permanent establishment, if a local individual or entity does any of the following in Mexico:

i. Exercises the power to execute contracts on behalf of the foreigner, in order to fulfill business activities.

ii. Performs business activities for a foreign entity doing business through a Trust. The site where the trustee performs his duties on behalf of the Trust is considered a place of business.

iii. Goes beyond the scope of an Independent Agent (see Comission Agent description to follow) by, for example:

   (a) Having goods and merchandise which he delivers on behalf of the foreigner;

   (b) Assuming risks on behalf of the foreigner;

   (c) Acting according to detailed instructions or under the general control of the foreigner;

   (d) Engaging in activities which in reality are economically of the foreigner, not of the agent himself;

   (e) Receiving compensation which is not dependent on results (i.e. guaranteed salary);

   (f) Executing transactions with the foreigner for consideration which is not comparable to consideration or prices used in similar commercial transactions (i.e. arm’s length).

Yet another area where permanent establishment can occur without a place of business, is in Construction activities. One who constructs, demolishes, installs, assembles, maintains, supervises or conducts inspection for more than 183 days, consecutive or not, within a twelve month period, has a permanent establishment. Any amount of time spent by sub-contractors performing any of the above listed activities will also count toward the aforementioned time limit.

Lastly, a foreign insurance company, through a person who is NOT an independent agent, who is either collecting premiums in Mexico (but not those from re-insurance), or insuring risks in Mexico, establishes a permanent establishment.
US-Mexico Exceptions to Permanent Establishment, per the US-Mexico Tax Convention: The U.S.-Mexico Tax Convention (Article 5) simplifies the ability to do business "with" Mexico by narrowing the definition of "permanent establishment." This treaty overrides Mexican statutory law with respect to U.S. businesses, and it defines "permanent establishment" as follows:

i. A non-independent agent who habitually exercises the authority to enter into contracts on behalf of a resident abroad; or who habitually processes goods or merchandise on behalf of a resident abroad, utilizing assets furnished by the resident abroad;

ii. The headquarters of management, branches, offices, factories, repair shops, mines, oil or gas wells, quarries, or any other place where natural resources are extracted;

iii. The construction, installation, and assembly projects of drilling installations, or platforms or ships used in the exploration or exploitation of natural resources, or inspection activities related to this, provided that its duration exceeds six months (without indicating if such term is consecutive or within a certain period); or

iv. Foreign insurance companies that, through a person who is NOT an independent agent, are either collecting premiums in Mexico (but not those from re-insurance), or insuring risks in Mexico.

d. What is not considered Permanent Establishment. The U.S.-Mexico Tax Treaty provides the following cases in which the law does not apply the concept of permanent establishment:

i. The use of an independent agent whose relationship with the foreign resident is arms-length;

ii. The maintenance of premises or installations for the sole purpose of storing, displaying or delivery of goods or merchandise;

iii. The keeping of goods or merchandise for a foreign resident, for the sole purpose of storing or displaying it or for being transformed by a third party (e.g. for "maquila" operations);

iv. Having a business place with the sole purpose of buying goods or merchandise or for obtaining information for the resident abroad;

v. Having a business place with the only purpose of performing "preparatory or auxiliary" activities for the foreign resident. These activities should consist of something similar to those of promotion, supply of information, scientific research, preparations to grant loans, or other similar activities; or

vi. Deposit of goods or merchandise of a foreign resident in a general deposit bonded tax warehouse, or their delivery for further importation into Mexico (Although this activity is not outlined in the Tax Treaty, it is implied in Mexican Law as an exception to permanent establishment).

e. Tax base of Permanent Establishments. In general terms, any foreign company with a permanent establishment in Mexico will be treated like a branch and taxed as a Mexican company.

The tax base for a permanent establishment will be all income derived from such establishment’s business activities in Mexico. This tax base includes income derived from the selling of goods and real estate in Mexico which was carried out by the permanent establishment’s central offices abroad. The permanent establishment will be allowed deductions for expenses incurred in the particular operation in Mexico which may be prorated with the head office or other offices located outside Mexico as long as those expenses relate to such operations. Remittances to such offices in payment of royalties, fees, commissions, etc. are not deductible.
f. Income Tax on Permanent Establishments. A permanent establishment is subject to the corporate tax rate of 30% applicable to the tax base as described above. This rate will be reduced 1% every year, until reaching a maximum of 28% in 2007.

Such permanent establishment must appoint a representative in Mexico who will be personally responsible before Tax Authorities for the corresponding tax filings.

g. Permanent Establishment as a Regulated Investment. The existence of the foregoing permanent establishment tax treatment refers to a situation in which the foreign entity establishes a presence in Mexico. Thus, because a permanent establishment situation results in the foreign entity doing business "in" Mexico for tax purposes, it may require a prior authorization or at least registration with Foreign Investments Authorities. Such authorization will depend on the interpretation given by the authorities to the concept of "doing business in Mexico" for commercial purposes.

The test of what constitutes "doing business in Mexico" is twofold. Does the business entity: (i) engage in commercial activities in Mexico?; and (ii) if so, does it conduct such activities regularly or continuously (a test of habit)? This is a highly fact specific investigation and is decided on a case by case basis. Conservatively speaking, it might be that Authorities will consider that the foreigner is regularly engaging in commercial activities in Mexico when performing two or more operations through a permanent establishment in a reasonably short period of time.

An agent in Mexico performing any of the foregoing activities will result in a "permanent establishment". Therefore, the agent will probably be deemed to be "doing business in Mexico" and therefore subject to authorization under the Foreign Investments Legislation.

2. Commission Agent (Commercial Intermediary). The appointment of a commercial intermediary implies the existence of a relationship whereby the contractor appoints an agent with limited powers. The extent of these powers should not include activities that make the foreigner have a permanent establishment in Mexico.

A commission agent conducts market research and promotes, solicits, and negotiates the sale of contractor’s products. The agent will only be furnishing the prospective Mexican clients with information such as pricing and payment policies. The agent can also process and forward orders, and can even accept payments on behalf of the foreign resident. Hence, the agent performs "preparatory or auxiliary" services for the contractor. These activities fall within the Mexico-United States exceptions to what is considered a permanent establishment, as discussed above.

The contractor abroad maintains authority to accept the purchase orders made by the Mexican customer, and in general determines the policy to be followed in the acceptance of the different offers.

The typical fee for an agent may consist of a straight commission on orders accepted, or a retainer plus commission.

If it is an independent contractor hired in Mexico for such purposes, it is customary to advise the agent to refrain from using the name and logo of contractor in his/her offices, business cards, or letterhead. This will avoid the appearance of having an establishment in Mexico and insure that the intermediary agreement is not a sham transaction.

A foreign company having a significant export volume or an extensive product range most commonly takes this route. It is probably best to contract with a company rather than hire an individual for these activities due to the fact that Mexican labor law favors the dismissed.

A. Tax Effects on Services in Mexico. Under the ITL, foreign residents or individuals who render subordinate or independent services within the Mexican Territory, not related with a "permanent establishment" as discussed above, will be subject to pay Mexican Income Taxes on the income derived therefrom in general, at a rate of 30% in 2005, to be
reduced each year, until reaching a maximum of 28% in 2007. This occurs if the services provided were rendered on Mexican Territory for more than 183 days (together or separate) within a period of 12 months (not a calendar year).

3. Distributor. As a third alternative, a distributorship agreement provides the foreign company with the opportunity to further develop sales and offer adequate service through yet another type of Mexican company or individual. The distributor acquires the products outside of Mexico from the foreign company and resells them on its behalf in Mexico.

The distributor may not appear as an attorney-in-fact of the foreign seller, but shall only function as a purchaser and further wholesaler/retailer of foreign merchandise to its customers in Mexico. Without authority to bind the foreign company and therefore being able to avoid the "permanent establishment" issue.


B. Dealers Acts. Mexico has not enacted a Dealers Act like many other Latin American jurisdictions. Such Acts regulate all distribution agreements in the host country, stating limitations as to the execution, performance and the causes of termination. In Mexico any distribution agreement will be governed by the general contract provisions of the Commercial Code which are very similar to the ones found in the Uniform Commercial Code of the U.S.

4. Transfer of Technology (Licensing). Another way of doing business "with" Mexico without creating a permanent establishment is to enter into a technology transfer or licensing agreement with a Mexican Party. Such agreements include: a) the license or authorization of exploitation of trademarks, patents or improvements, or industrial designs and utility models; b) the assignment of trademarks or patents; c) the supply of technical know-how and technical assistance in any form; d) the supply of basic or detailed engineering; e) the rendering of advisory, consulting and supervisory services; f) the license of copyrights that involve an industrial application; and g) the licensing of software.

5. Intellectual Property Law, its Amendments and Regulations. The primary pieces of legislation that govern the transfer of technology or licensing are the Intellectual Property Law and the Copyright Law and their Regulations. These Laws and their Regulations can not be waived by the parties to a contract involving intellectual property in Mexico. Thus, in drafting any such agreement, the parties must keep the Law and its Regulations in mind. The main aspects of current Intellectual Property Law, are delineated subsequently; Copyright Law will be further discussed hereunder.

A. Patents. Any individual or legal entity who legally creates an invention will have the right to its exclusive exploitation if protected by a properly registered patent. To be patentable, the invention must be:

(i) universally and absolutely novel; not be comprised in the prior art, which is defined as the technical information generally available to the public through a written or oral description, through working or any information means in Mexico or abroad;

(ii) the result of an inventive activity not readily deduced from the prior art, or which may be evident or obvious to an expert in the subject matter;

(iii) must have an industrial application.

With respect to the requirement of novelty, the amendments state that the invention to be patented may be introduced into the market for a period of up to one year before filing for the patent. This clarification will avoid potential problems for a person who has invented a product and already begun commercialization before patenting the product.
A patentable invention is one that permits the transformation of material or energy for the beneficial use of mankind to satisfy a concrete need. Under the Intellectual Property Law, the following are patentable in Mexico:

(i) Naturally occurring biological and genetic material;
(ii) Animal breeds and species;
(iii) Inventions related to living matter that makes up the human body; and
(iv) Plant varieties.

The term for patent protection for inventions is 20 years, and this term is counted from the time the application is submitted.

a. Patent Protection. Pharmaceuticals, medicines, animal feed, fertilizers, pesticides, herbicides, fungicides, chemical products and agrochemicals can be granted patent protection.

b. License or Assignment Registration. Any license or assignment of rights regarding patents registered in Mexico must be registered before the Mexican Institute of Intellectual Property (“IMPI”) of the Ministry of Economy. Any licenses or assignments of rights not registered before the IMPI will not be effective against third parties. The registration procedure requires a governmental review and approval on the merit. It takes between 15 to 20 weeks to receive a Patent Title.

c. Withholding Tax. The royalties from the use of patents are subject to a maximum withholding gross tax rate of 30% to be reduced by 1% every year, until reaching a maximum of 28% in 2007. Please note that in accordance with the provisions of the U.S.-Mexico Tax Treaty, the tax shall not exceed 10% of the gross amount of the royalties if the effective beneficiary is a U.S. resident.

d. Parallel Imports. The Regulations of the Intellectual Property Law allow a person or legal entity to legally introduce products bearing trademarks into Mexico only if: (i) such products are introduced into Mexico by the person or legal entity that is the owner or licensee of such trademark in Mexico; and (ii) the owners of the trademark in Mexico and abroad are of the same economic group or are their licensees.

e. International Protection of Patents. Companies may apply for protection in Mexico for products patented abroad beginning on the application date in the foreign country, provided: (i) the patent application was filed in a member country of The Patent Cooperation Treaty; and (ii) the exploitation of the invention or the import or commercialization of the product has not yet begun in Mexico. The patent's term will end in Mexico on the same date as in the country where the patent protection was originally granted.

B. Industrial Designs. Under the Intellectual Property Law, an industrial design is any industrial drawing or three dimensional form that is incorporated into or used as a pattern for industrial products for ornamentation purposes and that gives such products a distinctive character. Such industrial designs will be given patent protection if they are: (i) original; (ii) susceptible to industrial application; and (iii) significantly differ from other known industrial designs. Such industrial designs will receive 15 years protection.

C. Utility Models. Utility models are those objects that result from minor changes in tools, instruments and other devices, which represent a different function from the parts which integrate them, or a new improvement in their use. Utility models will be patentable if they are: (i) original; (ii) susceptible to industrial application; and (iii) significantly differ from other known utility models. Utility models are protected for a period of 10 years.
D. Trademarks. Any visible sign that distinguishes goods or services from other goods or services of the same variety in the same market can be protected through a trademark.

a. Registration and Period for Protection. Registration is granted to the first applicant. However, the first user in Mexico or abroad has a preferential right to register. A trademark should be registered with the Ministry of Economy (IMPI). Trademarks and service marks are protected for 10 year renewable periods. A simple sworn statement or affidavit attesting to uninterrupted use is enough for renewal. Use of trademark may not be discontinued for more than three consecutive years without justification, otherwise the registration could expire.

b. Legend. The legend "Marca Registrada" (Registered Trademark) or "®" must always appear on the trademarked material.

c. Collective Trademarks. The Law contains the concept of collective trademarks contemplated in the Paris Convention. Generally, collective trademarks are trademarks used by members of an association to identify their members in the market the goods or services sold or rendered by such association (i.e. the "tequila" distillers association).

d. License or Assignment of Trademarks. As is the case with patents, any assignment or license of rights regarding trademarks registered in Mexico must be registered at the IMPI in order to be effective against third parties. The registration procedure for trademark licensing or assignment is identical to that applicable for patents.

e. Withholding Tax. The royalties from the use of trademarks are subject to a maximum withholding gross tax rate of 30% to be reduced by 1% every year, until reaching a maximum of 28% in 2007. However, in accordance with the provisions of the U.S.-Mexico Tax Treaty, the tax shall not exceed 10% of the gross amount of the royalties if the effective beneficiary is a resident of the U.S.

f. Marks Not Registrable include.

1. Words or designs which are not sufficiently distinctive;
2. The proper, technical or commonly used names of products or services as words which are the usual or generic designation of the products to be covered;
3. Descriptive names or designs;
4. Names of places which are known for the manufacturing of certain products;
5. Names, figures or designs which are well know in Mexico; and
6. Names, figures or designs which are confusingly similar or identical to a previously registered trade or service mark or design that covers the same products or services.

E. Commercial Advertisements or Phrases. Those phrases or sentences that serve as an announcement of a commercial establishment, its goods or services, and serve to distinguish such goods or services, can be protected from use by other parties.

a. Registration. A commercial advertisement that meets the requirements established above can be registered with the Ministry of Economy and may be protected for 10 year renewable terms.

b. Withholding Tax. The royalties from the use of commercial advertisements are subject to a maximum withholding gross tax rate of 30% to be reduced by 1% every year, until reaching a maximum of 28% in 2007. Note
that in accordance with the provisions of the U.S.-Mexico Tax Treaty the tax shall not exceed 10% of the gross amount of the royalties if the effective beneficiary is a resident of the U.S.

F. Trade Names. Trade names are protected for 10 year renewable periods from the commencement of continuous use without the need to register. However, the holder of such trade name may register the name in order to establish the good faith of the user in its adoption and use. With respect to renewal of the registration, a simple sworn statement or affidavit attesting to uninterrupted use is sufficient.

a. Geographic Limits. The protection of trade names will only include the specific geographic area in which such trade name is used, but can be extended nationwide if the trade name is used and publicized on a national level.

b. Withholding Tax. The royalties from the use of trade names are subject to a maximum withholding gross tax rate of 30% to be reduced by 1% every year, until reaching a maximum of 28% in 2007. Note that in accordance with the provisions of the U.S.-Mexico Tax Treaty, the tax shall not exceed 10% of the gross amount of the royalties if the effective beneficiary is a resident of the U.S.

G. Franchising. Under Intellectual Property Law, a franchise will exist when with the license of a trademark, technical knowledge is transmitted or technical assistance is provided to allow a person or legal entity to produce or sell quality products or services in a uniform manner.

a. Registration. Franchising agreements including the licensing of trademarks and trade names and the supply of technical assistance and know-how are subject to registration with the IMPI. The registration procedure for these kinds of agreements is identical to that applicable for patent or trademark licensing or assignment agreements as explained above.

b. Withholding Tax. The royalties derived from franchise agreements involving copyrights on models, blueprints, formulas, procedures and commercial experiences (i.e. general know-how), as well as those involving technical assistance and transfer of technology in general, are subject to a withholding gross tax rate of 25%. The sections of such franchise agreements involving registrable items such as trademarks, patents, and publicity will be subject to a maximum withholding gross tax rate of 30% to be reduced by 1% every year, until reaching a maximum of 28% in 2007. As the two concepts are taxed separately, such agreements should separate the two concepts so that each will be taxed at the appropriate rate.

The items subject to a variable withholding rate of 25%, should be distinguished in price within the corresponding contract, from any of the concepts which are subject to a 30% rate (reduced to 28% by 2007). If distinguished, the withholding tax rate will be calculated proportionally. If this distinction cannot be determined, the withholding rate will be 30% for the entire contract.

In accordance with the provisions of the U.S.-Mexico Tax Treaty and ITL, as the case may be, the taxes on:

i. Copyrights on models, blueprints, formulas, procedures and commercial experiences shall not exceed 10% of the gross amount of the royalties, if the effective beneficiary is a resident of the U.S. This is due to the fact that all the concepts are considered as royalties for purposes of the U.S.-Mexico Tax Treaty.

ii. Technical assistance and the transfer of technology in general, shall be subject to a 15% gross tax. This is due to the fact that these concepts are not considered as royalties for purposes of the ITL.

iii. Services that do not fall within the above mentioned classifications will be levied at a 21% withholding gross rate under the ITL.
H. Origin Designations. An origin designation is the name of a region that serves to distinguish a product as originating from such area and whose quality and characteristics are exclusive to such area.

   a. Registration. Any party with legal stake as defined by law (i.e. production or factory associations, government entities, or entities whose business is production or elaboration in such area) may request an origin designation from the Ministry of Economy.

   b. Authorization to Use an Origin Designation. Once an origin designation has been registered with the Ministry of Economy, any individual or legal entity may request authorization to use such origin designation. Such authorization will usually be granted if such individual or legal entity can demonstrate that it is producing its goods or furnishing services from the region specified in the origin designation.

   c. Period for Authorization. The authorization for the use of an origin designation is for 10 years renewable periods. In general terms, the law provisions regarding origin designations are consistent with the Treaty of Lisbon.

   d. Withholding Tax. There is no withholding tax for the use of an origin designation.

I. Trade Secrets. A trade or industrial secret is information that has industrial or commercial applications that an individual or legal entity maintains as confidential and that gives such individual or entity a competitive and economic advantage over third parties.

   a. Registration. There is no requirement to register trade secrets with the Ministry of Economy, but the secrets themselves should be duly marked as confidential and evidenced in documents, optical disks, microfilms, films, or other similar instruments of the party purporting to be authorizing the use of trade secrets.

   b. Penalties. Unauthorized disclosure or use of trade or industrial secrets is considered a crime under the Criminal Code for the Federal District of Mexico. Currently industrial and trade secrets are broadly protected.

   c. Withholding Tax. The royalties derived from the authorized use of trade or industrial secrets are subject to a withholding gross tax rate of 25%. Likewise, in accordance with the U.S.-Mexico Tax Treaty, the tax shall not exceed 10% of gross amount of the royalties if the effective beneficiary is a resident of the U.S.

J. Infringement and Remedies for Violations of the Intellectual Property Law. Intellectual Property Law contains both administrative and criminal penalties for the infringement of its provisions. Among the administrative penalties are: (i) a one time fine of up to US$82,350.00; (ii) a fine of up to US$2,050.00 for each day that the infringement persists; (iii) temporary or permanent closure of the infringing party’s business operations; and/or (iv) administrative arrest for a period of up to 36 hours.

   Additionally, there are criminal penalties for the infringement of the law that include: (i) up to six years imprisonment; and (ii) fines of up to US$41,150.00.

   Finally, Intellectual Property Law specifically states that the imposition of either or both of the above penalties does not prevent the aggrieved party from seeking actual and consequential damages through civil proceedings.

6. Copyrights. The current Federal Copyright Law came into effect on December 24th, 1996 (last amendment on May 19th, 1997). The protection of Copyrights is granted by the government to authors for the creation of original, intellectual creations.
A. Economic and Moral Rights. Under Mexican law there are two types of rights granted to authors:

a. Economic Rights. To authorize or prohibit the reproduction, publication, public performance or display, importation, production of derivative works, or sale of such copyrighted works. These rights extend during the life of the author plus 75 years after death. Posthumous works are protected for 75 years after the date of first publication. These rights may be transferred or licensed, but such agreements must be in writing in order to be considered valid. Such agreements must be registered in the Public Registry of Copyrights in order to protect them against claims made by third parties.

b. Moral Rights. Includes the recognition of authorship and precludes the deformation, mutilation or modification of author’s work without prior authorization. The right is perpetual, non-transferable and cannot be waived.

B. Works Protected.

(i) literary, musical, dramatic, dance, pictorial, drawings, caricatures, sculptures, architectural, audio visual, photographic and applied art works that include graphic or textile designs;

(ii) data bases, which for reason of selection and arrangement of their content, constitute an intellectual creation and are protected as a compilation. Such protection does not extend to the dates and materials themselves; and

(iii) software protection extends to both operation and application programs in source or in object code.

C. Works not Protected include.

(i) formulas, solutions, concepts, methods, systems, instructions, principles, discoveries or processes;

(ii) the ideas contained in commercial or industrial advantages;

(iii) reproductions or imitations of codes of arms, shields, flags or emblems of whichever country, state, municipality or equivalent political division, nor the initials, symbols or emblems of international governmental organizations;

(iv) the texts of administrative or judicial rules and legislation or their official translations. In the event they are published, the publishers shall stick to the official text and will not be granted the exclusive edition right;

(v) the informative content of news; and

(vi) names or titles of isolated phrases.

D. Registration. Works that are protected should be brought before and registered with the Public Registry of Copyright. Registration will be denied to works that are:

(i) in the public domain;

(ii) already registered with the Public Registry of Copyright;

(iii) campaigns and promotional publicity;
(iv) when there is a notification of a trial or the initiation of a judicial proceeding in relation with a creation to be registered, the registration will be suspended; or

(v) in general the acts and documents that in their form or content contravene or are remote from the provisions of the law.

E. National Institute of Copyright. The functions of the Institute are to: (i) protect and support copyright; (ii) promote the creation of literary and artistic works; (iii) aid the Public Registry of Copyright; (iv) keep its historic archive current, and (v) promote international cooperation and exchange with institutions related to the registry and protection of copyright and connected rights.

F. Mexican Institute of Industrial Property. Will sanction any material infractions violating the rights of copyright holder. It has the power to investigate, order and perform inspections visits, and demand information and dates.

G. Withholding Taxes. The royalties from the use of copyrighted materials are subject to a withholding gross tax rate of 25%. Note that in accordance with the provisions of the U.S. Mexico Tax Treaty, the tax shall not exceed 10% of the gross amount of the royalties if the effective beneficiary is a resident of the U.S.

H. Penalties. Depending on the severity of the infraction, fines can range from 1,000 (one thousand) to 15,000 (fifteen thousand) days of the minimum daily wage valid at the time. (the current minimum daily wage is approximately US$4.50).

7. Protection of Intellectual Property under NAFTA. Countries which are a party to NAFTA agreed to implement adequate and effective protection of intellectual property rights. Many of these protective measures are currently contained in the current Intellectual Property Law and the Copyright Law. The requirements that Canada and Mexico provide extensive product and process patent protection for several types of inventions not previously protected as strongly in either country (e.g., pharmaceutical, agricultural chemicals, and various species of plant life) are among the many measures contained in NAFTA.

A. Provisions Regarding Enforcement. Additionally, NAFTA has specific provisions regarding enforcement of intellectual property rights. Such provisions include the following:

a. All defendants to an intellectual property claim will have the right to prior written notice of any claims.

b. All parties will have the right to independent counsel and will have the opportunity to substantiate their claims and provide relevant evidence.

c. There will be no overly burdensome requirements of personal appearances in court and, during the proceedings, all parties will adopt means to protect the confidentiality of the intellectual property in question.

d. Judicial authorities will have the power to require parties to provide evidence and to have evidence admitted if the other party does not provide evidence in a timely manner.

e. Judicial authorities shall have the power to enforce their findings and order infringing parties to pay damages.

f. Each party will institute procedures that will ensure enforcement of intellectual property violations at the border.

A. Powers Granted by Companies. In Mexico the rules of agency are more formal than in other countries (like the US). The legal system generally requires, that only: (i) a duly authorized officer of a company, or (ii) its Administration, or (iii) Partners/Shareholders, may grant powers to their agents ("representantes legales").

This granting procedure has to be in writing and through a Notary Public; and, if granted abroad, an additional "legalization process" (Apostille or Consularization) has to be carried out, as described below. In all cases these powers will need to be registered if the powers are for: (1) general: (i) lawsuits and collections, (ii) acts of administration, or (iii) ownership or domain acts; or (2) To incorporate a company; or (3) real estate related transactions.

Note that legal counselors (solicitors = lawyers who give legal advice and prepare legal documents) usually do not need a formally granted power of attorney, unless they act (like barristers) in the name and on behalf of clients in filings before courts or government agencies. Lawyers in Mexico can act as both solicitors (counselors) and barristers (litigators).

B. Powers Granted Abroad by Companies. Powers have to be granted before a local notary public, to provide assurance of the signatories, and thereafter "legalized" (Apostille or Consularization), as described below.

Since the Official language in Mexico is Spanish, the most practical and efficient procedure is to draft a bilingual (Spanish / English or other), double-column draft of the Power of Attorney. The specifics of the Power of Attorney will be the name of the Grantor, the name and position of the Officer who will be executing the powers on behalf of the Grantor, and the names of the Grantees or Agents, usually the lawyers of a law firm.

Since notarizations are only valid within the country where they took place, to make the notarization "official" in Mexico, a further legalization through an Apostille or a Consularization has to be carried out. The purpose and effect of either procedure is to assure the Mexican authorities that the powers were legally granted abroad.

C. Powers Granted Abroad - Apostille. Once the document where the powers are embodied has been notarized, it must be "apostilled" by the local Ministry of Internal Affairs of the jurisdiction where the notarization took place. In the U.S. this will be the local Secretary of State. This Agency, once it verifies the proper authority of the local notary, will attach to the document a piece of paper called the "Apostille," as evidence of legalization.

Note that both the nation presenting and receiving the apostilled document MUST be signatories of the Convention (Mexico acceded in 1994, the United States in 1981; Canada is not yet a signatory).


D. Powers Granted Abroad - Legalization. For countries not Members of the Hague Convention, they will still need to follow the rules of the Protocol for Legalization for Foreign Public Documents of Panama. Therefore, the notarized document must be taken instead to the local Mexican Consulate for Legalization.

E. Agent-in-Fact ("Gestor Oficioso"). Note however, that Mexico recognizes the concept of "agent-in-fact" called "gestor oficioso". This is an Agent who legally acts in the name of another (principal) in an urgent legal situation. This action should be further ratified by the principal.

This agent-in-fact is in reality an "attorney-in-fact" rather than an "attorney-in-law." When warranted, and as instructed by clients, our Firm has entered into agreements, made filings before government agencies, and even established companies using this concept. This is usually in an urgent situation, where the time needed to follow the
formalities for granting powers will not be enough, and the client will be negatively affected or make its case moot.


A. Representative Offices – Generally. A Representative Office ("Oficina de Representación Sin Ingresos") is an office that does not undertake any of the commercial (income yielding) activities considered "permanent establishment" activities. It is an optimal way to have a presence in Mexico, without actually being considered as "Doing Business IN Mexico," when the foreign entity’s main goal can be fulfilled via promotional, liaison, and headquarters/branch collaboration activities. The bottom line is being NON-INCOME YIELDING. This is often the best way to introduce the foreign entity to the market potential in Mexico.

B. The Establishment of Representative Offices. The procedures and regulations with which the foreign entity must comply are straightforward. As to registry, none is required on the local Registry of Commerce, as the Representative Office will not be a "business entity." The foreign entity is also not considered a "foreign investor" and will not be regulated by the Foreign Investments Law, nor will it have to register on the Registry of Foreign Investments.

The specific steps to be undertaken will vary greatly with the individual needs of the foreign entity. Since Representative Offices are Cost Centers, and since a non-resident entity is normally exempt from withholding tax duties, Tax Registration, as a withholder, may be required and therefore a tax representative will be appointed. This can occur, for example, if any value added tax is received by the foreign entity. Again, although usually exempt, compliance with contractor income tax withholding rules may be required. Because many of the decisions need to be made on a case by case basis, it is important to obtain local counsel during the process.

C. Representative Offices: Promoting Insurance.

a. Allowable Activities. When making initial contact with the Mexican insurance market, it may be favorable to initiate activities without either establishing a subsidiary nor a representative office. Examples of the allowable activities are as follows (describing what a representative of the foreign entity may do in regards to communications with a prospective/existing client):

i. communicate by telephone and/or meet in person and discuss the potential sale of products not available in Mexico, or with international coverage not including Mexico;

ii. personally provide general illustrations, and deliver brochures about theoretical policies or specific policies, regarding insurance products with no coverage in Mexico;

iii. deliver applications for insurance with coverage outside of Mexico, such agreements to be executed outside of Mexico;

iv. use the postal system to deliver applications, brochures, or other printed materials, so long as such literature is not mailed to the general public;

v. use electronic means (e-mail and downloading) in order to deliver an application, provided it is not for coverage in Mexico, and that it will not be executed in Mexico; and

vi. deliver insurance policies in Mexico using courier services.

An existing/prospective client of a foreign entity acting under the above rubric (initial contact with the Mexican insurance market), may do the following:
i. mail premiums in local or foreign currency either to the insurance representative or directly to the insurance company, provided the policy was not executed in Mexico;

ii. undergo a medical examination and complete the medical portion of an application in Mexico, provided the medical staff is authorized to practice in Mexico, the policy is not executed in Mexico and does not provide coverage in Mexico; and

iii. call from Mexico a representative outside of Mexico to discuss insurance products with coverage outside Mexico.

Under no circumstances, in any of the above allowable scenarios, may the application or contract be executed in Mexico, nor may the insurance policy provide coverage in Mexico.

**Allowable activities with permission (revocable):** Per Art. 3, §III of the Insurance Law (*Ley General de Instituciones y Sociedades Mutualistas de Seguros*), Foreign entities, with prior permission from the Ministry of Treasury and Public Credit (*Secretaría de Hacienda y Crédito Público*), may execute insurance contracts on Mexican territory insuring risks which can only occur on foreign territory where the foreign entity is authorized to offer insurance services. Also, a person who can prove that no national insurance provider is willing or able to insure the proposed risk, will be given special permission to contract directly or indirectly with a foreign entity.

Per Annex VII, Part A of NAFTA, Mexico has allowed certain insurance contracts by Mexican residents, when purchased from another Party to NAFTA. These include: tourist insurance for individuals, cargo insurance for goods in international transition from point of origin to final destination, and insurance for any kind of vehicle (air, space, water, land) during its use in transportation of cargo, as long as that vehicle is licensed and registered outside of Mexico, and, insurance for intermediary services of the above. The overall caveat, however, is that it must all be purchased without active solicitation. The NAFTA section described above does not apply to reinsurance (see section below).

**b. Prohibited Activities.** Per Article 3 of the Insurance Law, the following summary delineates some of the prohibited activities when contracted with foreign entities: personal insurance, when the insured executes the contract within Mexico; any vehicular insurance (air, land or water) for vehicles registered in Mexico, or owned by residents of Mexico; credit insurance, when the insured is subject to Mexican law; liability insurance when insuring actions which may occur in Mexico; any kind of insurance against any risk which may occur in Mexico, etc.

Any contracts executed in contravention to these rules, will be considered null and void and will have no legal effect whatsoever, without prejudice to the insured’s rights.

Additionally, per the Income Tax Law’s permanent establishment parameters, a foreign insurance company, through a person who is NOT an independent agent, who is either collecting premiums in Mexico (but not those from reinsurance), or insuring risks in Mexico, establishes a permanent establishment. As mentioned above, due to the highly regulated insurance environment, it is not advisable to create a permanent establishment.

Nevertheless, in order to yield income in Mexico and comply with the law, it is advisable to establish a subsidiary office. This arrangement is discussed in detail below (see, V. Doing Business in Mexico- Special Areas: 9. Insurance).

**D. Representative Offices: Reinsurance.** The establishment of a representative office for reinsurance by a foreign entity is allowable. Such representative offices will abstain from any of the above-mentioned prohibited activities. Representative offices will be subject to regulation by the Ministry of Treasury and Public Credit. Such offices will also comply with the insurance publicity and advertising rules.
All advertising and publicity effectuated by insurance institutions in Mexico, are subject to the oversight, rules and regulations promulgated by the National Commission on Insurance and Bonds (Comisión Nacional de Seguros y Fianzas). Generally, per Article 71 of the Insurance Law, advertising and publicity must include the use of clear and precise language, with the goal of avoiding the public’s deceit, mistake, or confusion as to the services being offered. The Ministry may revoke authority to function as a representative office.

E. Representative Offices: Securities Promotion.

a. Establishment. The establishment and operation of a representative office in the securities sector is regulated as to activities within the national stock market. Only very limited international market activities are allowed by foreign representative offices.

b. Allowable Activities. Examples of allowable activities regarding the international stock markets include: performing general activities regarding the promotion of such markets; meeting with existing or potential clients; rendering general advisory services; maintaining contact via telephone, email or mail regarding availability of services and recommendation of certain securities; and establishing reference contacts in Mexico and economically compensating them for client referrals.

The Representative Office must be non-income yielding, and execution of all investment accounts, agreements, and other documents will occur outside of Mexico and should be submitted to jurisdiction outside of Mexico.

c. Regulated Activities. The regulated activities of a Representative Office are summarized below. Per Art. 27 Bis of the Mexican Stock Market Law (Ley del Mercado de Valores) (the "MSML") a representative office of a foreign brokerage firm (casa de bolsa) may not, within the national market:

i. perform any of the federally regulated brokerage firm financial operations which require authorization from the federal government;

ii. supply information about such financial operations (i.e. specific trade information);

iii. take any preliminary, direct, or indirect steps toward such financial transactions; and

iv. actually perform any such financial transactions.

The MSML (Art. 4) defines "brokerage firm financial operations" as the regular performance of:

i. activities which facilitate the buying/selling of securities;

ii. individual activities regarding public offer securities issued and guaranteed by third parties; and

iii. the administration or management of securities which are the property of others.

The above "brokerage firm financial operations" may only be performed by those authorized by the MSML.

d. Generally. The establishment of a Representative Office must be authorized by the Ministry of Treasury and Public Credit. All Representative Office activities will be subject to the regulations of the Ministry, in consultation with the National Banking and Securities Commission (Comisión Nacional Bancaria y de Valores). The Ministry may revoke permission to establish and function as a Representative Office. The National Banking and Securities Commission will have inspection and oversight jurisdiction over Representative Offices.
However, in order to yield income in Mexico and comply with the law, it is advisable to establish a subsidiary office. This arrangement is discussed in detail below (see, V. Doing Business in Mexico- Special Areas: 10. Stock Brokerage Houses).

IV. DOING BUSINESS "IN" MEXICO.

Foreigners, depending upon their need to have presence and involvement in Mexico from a commercial point of view, may opt to do business "in" Mexico by employing a subordinate agent, establishing a Mexican company or acquiring stock in an existing Mexican company. The use of any of these methods will create a permanent establishment and will result in doing business "in" Mexico.

1. Incorporation of a Mexican Company. The basic procedures related to the organization of a new Mexican company with 100% foreign capital participation are as follows.

A. Initial Corporate and Administrative Obligations. Below is an outline of the most common initial corporate and administrative steps to be taken in order to comply with Mexican Law.

a. Corporate:

i. Acquisition of a Corporate Name;

ii. Formation of the Company before a Notary Public;

iii. Inscription on the Public Registry;

iv. Opening of the Corporate books: shareholders resolutions, board of directors/managers resolutions, shareholder register, and the variable capital register;

v. Issuance of provisional and definite shares or partnership parts certificates; and

vi. Open bank account and deposit initial and working capital.

b. Tax:

i. Registration on the Tax Registry;

ii. Monthly Tax reports; and

iii. Annual Tax reports.

c. Foreign Investments:

i. Registration on the Foreign Investments Registry;

ii. Quarterly Reports; and

iii. Annual Reports.
d. Labor:
   i. Individual Contracts;
   ii. Collective Bargaining Agreements with Labor Union;
   iii. Pension Plan;
   iv. Savings Fund; and
   v. Registration on the Social Security System (IMSS) and Employee Housing Trust (INFONAVIT).

e. Environmental:
   i. Environmental Impact and Risk Assessment Study;
   ii. Management, storage, transport, etc. of industrial residues; and
   iii. Use and exploitation of water, and the obligations regarding discharge of residual water.

f. Foreign Trade:
   i. Registration on the Importers/Exporters Registry;
   ii. Tariff classification for duty calculations;
   iii. Country of Origin Rules to comply with international trade agreements;
   iv. Compliance with Mexican Mandatory Standards;
   v. Price Assessments on Imports for calculating duties;
   vi. Compliance with Price Transferring Rules; and
   vii. Import Permits and Quotas.

g. Export Incentive Programs:
   i. Maquiladora;
   ii. PITEX
   iii. ALTEX; and
   iv. ECEX.

h. Immigration:
   i. Visa for foreign employees residing in Mexico and receiving income from Mexican sources.
B. Corporate Forms. The Federal Companies Law ("Ley General de Sociedades Mercantiles") provides for several types of companies that can be organized. There are various differences in their legal and tax treatment, depending on which form is chosen.

a. Sociedad Anónima. It is usually recommended to incorporate a limited liability stock corporation ("Sociedad Anónima"), which may adopt the form of a fixed capital company ("S.A.") or that of a variable capital company ("S.A. de C.V."). The principal difference between the two is that the latter may increase or decrease its capital within the limits established in the By-Laws by a mere Stockholders’ Meeting resolution without the need to fulfill further formalities. Nevertheless, both types of companies give notice of any capital amendment to the National Registry of Foreign Investments.

The key characteristics of both types of companies are:

i. Shareholder’s liability is limited to their stock interest in the company;

ii. Directors are fully liable for the loyal and diligent administration of the company;

iii. The company must have at least 2 (two) shareholders and a minimum capital of MexCy $50,000.00 (Fifty Thousand Mexican Pesos 00/100); 20% (twenty percent) of which must be paid at the time of incorporation; and

iv. Must appoint a statutory examiner, who is a disinterested third party supervising the operations of the company and representing the interests of the shareholders;

v. The tax rate will be the corporate tax rate of 30%. This withholding rate will be reduced by 1% each year until reaching a maximum of 28% in 2007; and

vi. The shares which represent the capital stock of the company are freely transferable and can be traded publicly, after the corresponding filings take place.

b. Limited Liability Company. Another form of limited liability company, the "Sociedad de Responsabilidad Limitada" or "S. de R.L.," has become popular among foreign companies.

The key characteristics of the "S. de R.L." are as follows:

i. Partners’ liability is limited to their partnership interest in the company;

ii. Directors are fully liable for the loyal and diligent administration of the company;

iii. The company must have a minimum of 2 (two) partners and a maximum of 50 (fifty), and a minimum capital of MexCy $3,000.00 (Three Thousand Mexican Pesos), of which 50% (fifty percent) must be paid at the time of incorporation;

iv. There is no requirement to appoint a statutory examiner;

v. The tax rate will be the corporate tax rate of 30%. This withholding rate will be reduced by 1% each year until reaching a maximum of 28% in 2007;

vi. The shares which represent the partnership interests in the company are neither freely transferable nor traded publicly. The shares of a S. de R.L. need not be issued.
vii. The key U.S. tax benefits for a U.S. parent company are: When the U.S. entity is an LLP or LLC ("S" corporation in Michigan), then it is advantageous to establish presence in Mexico as an S. de R.L. (the Mexican equivalent of the LLP or LLC). Under U.S. Federal Tax rulings, in order to benefit from the "flow-through" or "pass-through" tax treatment given to these specific limited liability entities, the subsidiary from which any income is received, must be an "equivalent" to the parent partnership company; i.e. S. de R.L. The benefit received involves only being taxed at one level, and not at both the corporate and then distribution levels. An additional benefit is that if the partners of the wholly owned subsidiary are not residents of Mexico, they will not be subject to any federal or local income taxation in Mexico.

viii. The equity in the S.de R.L. is represented by "partnership parts." Each partner has one "part," each "part" may have a different economic value. Third parties cannot become partners unless approved by all the partners. An S. de R.L. cannot go public.

c. General Partnership. Another form of business entity is the general partnership or the "Sociedad en Nombre Colectivo" (the "S.N.C."). A distinct disadvantage of the SNC is that all of the partners have unlimited liability with respect to obligations and debts. This corporate form is not frequently used in Mexico.

d. Limited Partnership. The limited partnership or the "Sociedad en Comandita Simple" (the "S.C.S.") has two types of partners: the active partner(s) who has unlimited liability, and the silent partner(s) who is liable only for their capital contribution. This corporate form is also not frequently used in Mexico.

e. Mexican Branch. Another possibility for a foreign company is to operate through branch offices in Mexico. As foreign companies are legally recognized in Mexico, they retain their liability characteristics from abroad. However, to carry out business operations, such branches must be approved by the National Commission on Foreign Investments ("NCFI") and the Ministry of Foreign Relations, and be registered at the Public Registry of Commerce.

For tax purposes, the foreign company will receive the same treatment as a permanent establishment in Mexico (see above) and will pay taxes on the income generated from such branch offices at the normal corporate tax rate of 30%, to be reduced by 1% each year until reaching a maximum of 28% in 2007. However, the foreign company should be careful to avoid the possibility of having the income generated by the foreign company outside of Mexico become attributable to the operations in Mexico. This possibility is due to the "force of attraction" rules contained in Mexico’s tax legislation, which will sometimes require a taxpayer to include in his taxable income, income generated from abroad.

f. Association in Participation. The Association in Participation ("Asociación en Participación" or "AP") is another common form of doing business "in" Mexico. Generally, an AP is an agreement in which one or more partners ("asociados") give goods or services to a managing partner ("asociante") in exchange for a right to participate in the profits of a commercial operation which is controlled by such managing partner.

For commercial purposes, the Association in Participation is not a separate legal entity. However, for tax purposes it is a separate entity and requires registration.

g. Joint Venture Agreement. In a Joint Venture Agreement ("JVA") two or more persons jointly undertake a business venture for a period of time. A JVA defines the "business equation" among the parties. The JVA can take any form to which the parties agree. Here, the Parties agree on how they will provide their respective contributions, share risks and divide profits. The exact type of business venture determines the liability and tax treatment. The flexibility of a JVA has made it popular among investors.
The JVA is a private agreement, which will establish the business relationship among the parties. The JVA could yield an additional commercial company whose By-Laws become public when registered at the Registry of Commerce. We do not recommend that the "business terms" of the JVA be defined within the By-Laws since the public in general will learn about the "business equation" among the parties. The By-Laws typically refer only to the administration of the company.

The mere existence of the By-Laws of a company without a previous JVA could lead to misunderstandings. Both the JVA and the By-Laws, of a related company, have the same validity among the parties involved. Nevertheless, the By-Laws will also have effect before third parties, for example in the powers granted to the administrators of the company. Even though verbal/oral agreements are valid in Mexico, a written JVA is recommended.

C. Steps for Incorporation. Similar steps are taken as with other corporate forms. To establish a Limited Liability Stock Corporation ("Sociedad Anónima") or a Limited Liability Company ("S. de R.L.") (the two most common corporate forms), the steps will be the following:

a. File for an Incorporation Permit for the company under a proposed name before the Ministry of Foreign Affairs. This authorization will take around two to three working days.

b. Incorporate the Company before a Notary Public or Commercial Broker. The Company's initial capital contributions must be paid in full if it is paid in kind, or if in cash it can be partially paid at a minimum of 20%. In the case of the "S. de R.L.", the initial paid amount is 50%. The Company must issue registered share certificates, and the shareholders must be registered in the Company Stock Registry Book. Share Certificates are not necessary in a S. de R.L.s.

c. Concurrent with the incorporation, the shareholders/partners must hold a General Ordinary Shareholders'/Partners' Meeting resolving on: (i) the structure of the capital stock; (ii) acknowledgment that the fiscal year will run together with the calendar year except for the first year which will be irregular; (iii) appoint a Sole Administrator or a Board of Directors; (iv) appoint at least one "Examiner" (statutory auditor) to monitor Company’s administration on behalf of the shareholders (In the case of the S. de R.L. there is no requirement for an examiner); and (v) appoint a General Manager and any other officers or agents.

d. The Sole Administrator or the Members of the Board of Directors of the Company may be foreigners and Board of Directors’ meetings may be held in or outside of Mexico. If the Sole Administrator or Directors are not Mexican citizens and will be acting in Mexico, they need a migratory permit.

e. The Examiner (in the case of a "Sociedad Anónima") usually is an accountant from an accounting firm who regularly audits the Company. Also, an alternate Examiner could be appointed because this position cannot be delegated at will.

D. Time Frames. Besides obtaining prior approval from Foreign Investments Authorities (if necessary), the incorporation date of the Company is dependent upon: 1) drafting of the By-Laws to be used for the Company and the first Shareholders'/Partners’ Meeting Minutes; 2) execution and formalization of special powers of attorney to incorporate the new Company (if any); 3) the approval of the corporate name by the Ministry of Foreign Affairs; and 4) an appointment date from the Notary Public or Commercial Broker for signing the incorporation deed.

E. Operating and Services Companies. Mexican Labor Law (Ley Federal del Trabajo) is drafted with a strong bias towards the employee. For example, under the Law there is no "employment at will," and termination of an employee may occur only for rigid, statutorily mandated reasons. Another noteworthy pro employee provision, is that the Labor Law provides for compulsory profit sharing of 10% of pre-tax earnings to be distributed among employees, other than a few high ranking officers (general manager, general production manager, for example).
Due to the above mentioned employee-biased Labor Law, establishing two companies congruently is common and advisable. The "Operating Company" actually generates income, while the "Services Company," administers employee related issues, such as the hiring and firing thereof, and provides services to the "Operating Company." The companies are related to one another via an inter-company services agreement.

2. Foreign Investment under NAFTA. NAFTA has encouraged greater investment in Mexico by: (i) eliminating or reducing many existing barriers to foreign investment; and (ii) establishing rules for the protection of foreign investors and their investments (NAFTA, Chapter 11).

A. Elimination of Barriers to Foreign Investment. NAFTA’s "National Treatment" obligation requires that the Governments of Canada, Mexico and the U.S. (the "Parties") provide investors of anyone of the Parties ("NAFTA Investors") treatment no less favorable than that enjoyed by investors of each Party (NAFTA, Art. 1102). Discrimination against investors of any Party, violate the national treatment obligation and therefore are prohibited by NAFTA.

However, each of the Parties has negotiated exceptions to the National Treatment obligation for sensitive industries (listed in Annexes I, II and III of NAFTA). While Mexico has included the longest list of exceptions, it also has agreed to make the most changes in its foreign investment rules. For example, Mexico is gradually phasing-out restrictions on foreign investment in the construction, automotive parts, and mining industries which are currently subject to a maximum foreign investment. NAFTA Investors will be allowed to participate in industries that were previously reserved exclusively to Mexicans (i.e., commercial aviation, cable television, and surface transportation). In addition, Mexico has agreed to gradually lift a variety of restrictions on foreign investment in the financial services industry (see NAFTA, Chapter 14).

Under NAFTA, Mexico only requires foreign investors to apply for the authorization from the National Commission on Foreign Investments ("NCFI") to acquire existing Mexican companies if the value of their gross assets exceeds certain threshold (limit) amounts specified in Annex I of NAFTA.

B. Greater Security for Foreign Investors.

a. Currency Transfers. NAFTA also establishes rules to protect NAFTA Investors from important risks associated with investing abroad. The Parties have agreed to allow all currency transfers and international payments relating to an investment of a NAFTA Investor to be made freely and without delay, subject to narrow exceptions relating to bankruptcy, criminal proceedings (e.g., money laundering), and the satisfaction of civil judgments (NAFTA, Art. 1109).

b. Standards for Expropriation. The Parties have agreed to abide by special rules for expropriation or nationalization of property of a NAFTA Investor.

No Party may, directly or indirectly, expropriate investments of NAFTA Investors except for: (i) a public purpose; (ii) on a non-discriminatory basis; (iii) in accordance with principles of due process of law; (iv) upon payment of adequate compensation (the fair market value of the investment); and (v) without delay (NAFTA, Art. 1110).

c. Arbitration of Investor-State Disputes. In addition to the arbitration provisions for the settlement of disputes between the Parties (see NAFTA, Chapters 19 & 20), NAFTA provides for arbitration of disputes between NAFTA Investors and the Governments of the Parties (NAFTA, Arts. 1115 to 1138).

Should the Government of a Party violate the investment provisions of NAFTA, the injured NAFTA Investor may claim damages or restitution from the Government of such Party in special arbitration proceedings.
In accordance to NAFTA, Mexico has agreed to arbitrate investment disputes with Canadian and American investors. Now a NAFTA Investor may challenge another Party’s Government’s compliance with NAFTA rules by either: (i) bringing a judicial action in the courts of the Party where the investment was made; or (ii) submitting the claim to arbitration according to the rules of Chapter 11 of NAFTA. Therefore, investors from Canada, Mexico, and the U.S. enjoy guarantied access to an impartial arbitral tribunal to resolve disputes with Governments of the other Parties.

3. Current Foreign Investment Provisions. The Foreign Investments Law ("FIL") was published on December 27, 1993 and was most recently amended on June 4, 2001. The Regulations for the current Investment Law were published on September 8, 1998.

A. Foreign Investors and Investment. A "foreign investor" is an individual or legal entity of a nationality other than Mexican. In turn, "foreign investment" is the participation of foreign investors, in any proportion, in the capital stock of Mexican companies, in the activities regulated by the Investment Law, or any investments performed by Mexican companies with a majority of foreign capital.

B. General Rule. As a general rule, foreign investors can participate in any proportion, in the capital stock of Mexican companies, acquire fixed assets, enter into new areas of economic activity, manufacture new product lines, or open and operate establishments, including the enlargement or relocation of those already in existence, except as provided for in the Investment Article of the FIL.

The rules in the FIL regarding the participation of foreign investment in the financial sector activities, shall be applied without prejudice to what is provided for by the specific statutes applicable to those activities.

C. Activities Restricted to the State. The activities exclusively reserved to the State are the following:

1. Petroleum and other hydrocarbons;
2. Basic petrochemicals;
3. Electricity;
4. Generation of nuclear energy;
5. Radioactive minerals;
6. Telegraph;
7. Radiotelegraph;
8. Postal service (excluding courier);
9. Currency: issuing coins & bills; and
10. Control, supervision and surveillance of seaports, airports and heliports.

D. Activities reserved to Mexicans. The activities reserved to Mexican nationals or Mexican companies with a Foreigners Exclusion Clause are indicated below. All incorporated companies which engage in such activities must contain a Foreigners Exclusion Clause. Such Clause is the express covenant in the company’s by-laws, establishing that the company in question shall not admit foreign investors nor companies with a foreigners admission clause, as partners or shareholders either directly or indirectly.

1. Domestic land transportation of passengers, for tourism and of cargo, excluding messenger and package delivery services;
2. Retail trade of gasoline and distribution of petroleum liquidated gas;
3. Radio broadcasting services, and other radio and television services different from cable television;
4. Credit unions;
5. Development banking institutions; and
6. Rendering of professional and technical services which are expressly provided for in applicable legal provisions.
Foreign investors in this Section or in the Section below (Activities with Specific Regulation) shall not be able to participate directly in the foregoing activities nor may they use trusts, contracts, statutory or corporate agreements, pyramid schemes or other mechanism granting to the foreign investment any control or participation, except through "neutral investment" as indicated below.

E. Activities with Specific Regulation. In the following economic activities foreign investment shall be able to participate in the percentages mentioned below. (Note: when calculating percentage of Mexican/foreign ownership, shareholder entities are considered Mexican if they are majority owned by Mexican shareholders).

1. Up to 10% in co-operative production (employee owned) companies;

2. Up to 25% in:
   a. Domestic air transportation;
   b. Air-taxi transportation; and
   c. Specialized air transportation;

3. Up to 49% in:
   a. Insurance companies;
   b. Bonding institutions;
   c. Currency exchange houses;
   d. General Deposit Warehouses;
   e. Financial leasing companies;
   f. Factoring Financial Services;
   g. Limited-Purpose financial companies (i.e. "Afores" for its acronym in Spanish);
   h. Brokerage services companies;
   i. Stock representing the fixed capital of investment companies;
   j. Operating companies of investment companies;
   k. Retirement Fund Managing Companies (i.e. "Afores" for its acronym in Spanish);
   l. Manufacture and distribution of explosives, firearms, bullets, munitions and fireworks, excluding the acquisition and use of explosives for industrial and extracting activities, as well as the manufacture of explosive mixtures for use in such activities;
   m. Printing and publication of newspapers for exclusive circulation in the Mexican Territory;
   n. Series "T" shares of companies who own farming, ranching or forestry land;
   o. Fishing in freshwater, coastal and the restricted economic zone waters, excluding fish farms;
   p. Integral seaport management;
   q. Seaport piloting services for ships to perform interior navigation operations;
   r. Shipping companies dedicated to the commercial exploitation of ships for interior and coastal navigation, except for tourist cruises and the exploitation of dredging and nautical devices for seaport construction, maintenance and operation;
   s. Supply of fuel and lubricants for ships, airplanes and railroad equipment; and
   t. Concessionaire companies Telecommunications Law for (basic local and long distance telephone service).

F. Activities for Specific National Commission on Foreign Investments ("NCFI") Approval. A favorable resolution from the NCFI is required so that foreign investment is able to participate in a percentage greater than 49% in the following activities:

1. Seaport services for ships so they can perform their interior navigation operations, such as towing, mooring of vessels and ferrying;
2. Shipping companies dedicated to the exploitation of ships exclusively in high seas traffic;
3. Companies receiving concessions or permits to operate public service airfields;
4. Private educational services of preschool, elementary middle school, high school, college and university;
5. Legal services;
6. Credit information companies;
7. Securities rating institutions;
8. Insurance agencies;
9. Cellular telephone services;
10. Construction of pipelines for the transportation of oil and oil derivatives;
11. Drilling of oil and natural gas wells; and
12. Construction, operation and exploitation of railways and rendering railroad services.

In addition, following NAFTA rules as indicated above, a favorable resolution from the NCFI is required if foreign investment will participate, directly or indirectly, in a proportion greater than 49% in the capital stock of Mexican companies, only when the total value of the companies’ assets, at the time of submitting the acquisition application, exceeds the amount annually determined by the NCFI. Such amount was fixed in 2003 at MexCy $1,565,895,000.00. As provided by NAFTA, the Mexican Government will update this amount annually depending upon the exchange rate (on September 24, 2004, the new amount was fixed at MexCy $1,818,404,000.00).

a. Transport Activities - Special Rules. Per the FIL, the following activities were previously reserved exclusively to Mexicans or Mexican corporations with a foreigners exclusion clause:
   a) international land transport of passengers,
   b) tourism and cargo transportation between destinations within Mexico, and
   c) administrative services of passenger truck exchanges and auxiliary services.

   However, after January 1, 2004, a foreign investor may participate in the abovementioned activities, in up to 100% of the capital stock of a Mexican company without the need of a favorable ruling from the NCFI.

b. Automotive Industry - Special Rules. Foreign investment will be able to participate in up to 100% in the capital stock of a Mexican company dedicated to the activities of manufacturing and assembling of parts, equipment and accessories for the automotive industry without the need of a favorable ruling from the NCFI.

c. Videotext and Switchboard Services - Special Rules. A foreign investor may participate up to 100% in companies that provided the afore mentioned services, without the need of a favorable ruling from the NCFI.

d. Construction - Special Rules. The foreign investment may participate in up to 100% in the capital stock of Mexican companies dedicated to performing building, construction and installation of "obras" (works) activities, without the need of a favorable ruling from the NCFI.

G. Investments by Foreign Legal Entities. Foreign legal entities may engage in commercial activities in Mexico, but it is necessary to obtain authorization from the Ministry of Economy for its inscription in the local Public Registry of Commerce, in accordance with Articles 250 and 251 of the Companies Law.

Every application for such authorization shall be decided upon by the Ministry of Economy within 15 working days following the date of filing.

H. Neutral Investment. Neutral investment will not be computed to determine the percentage of foreign investment in the capital stock of Mexican companies or in authorized trusts.

   a. Neutral Investment - Trust Instruments. The Ministry of Economy may authorize trustee institutions to issue neutral investment instruments that can only grant, with respect to corporations, pecuniary rights to its
shareholders and, as the case may be, limited corporate rights, without conferring upon them the right to vote at general ordinary meetings.

b. **Neutral Investment - Special Shares.** The investment in shares without voting rights or with limited corporate rights shall be considered neutral, provided that the authorization from the Ministry of Economy, and when applicable the one from the National Stock Exchange Commission, is previously obtained.

c. **Neutral Investment in Financial Type Companies.** Per the opinion of the Ministry of Treasury and Public Credit and the National Stock Exchange Commission, the Ministry of Economy may resolve disputes regarding neutral investment through the acquisition of Ordinary Participation Certificates issued by authorized trustee institutions, whose patrimony may be formed by Series "B" shares representative of the capital stock of controlling companies of financial groups, of multiple banking institutions, or of Series "A" shares representative of the capital stock of stock brokerage houses.

d. **Neutral Investment by International Development Financing Companies.** The NCFI may resolve issues concerning neutral investment that international development financing institutions intend to carry out in the capital stock of companies. The future Regulations to this Investment Law will provide for the terms and conditions of such type of investments.

e. **Resolutions of the National Commission on Foreign Investments.** The NCFI shall make resolutions on the petitions (applications) filed before it within 45 working days starting from the date of filing. If the NCFI does not resolve within the foregoing period, the application shall be deemed approved in the terms presented.

To evaluate the applications submitted for its consideration, the NCFI shall take into account the following criteria: (i) Impact on the employment and training of the employees; (ii) Technological contribution; (iii) Compliance with the environmental provisions contained in the environmental regulations that govern such area; and (iv) Contribution to increase the competitiveness of the Country’s productivity plan.

The NCFI shall only impose requirements that do not interfere with international trade (e.g. NAFTA) when making decisions on an application. However, it may forbid foreign investment acquisitions for national security reasons.

I. **Registry of Foreign Investments.** The following shall be inscribed in the Registry: (i) Mexican companies in which foreign investment participates; (ii) Foreign individuals or legal entities that habitually perform acts of commerce in the Mexican Republic, and branches of foreign investors established in the Country; and (iii) Trusts of stock or shares, real estate and of neutral investment, through which rights are derived (granted) in favor of foreign investment.

The individuals or legal entities referred to in Sections (i) and (ii) shall have the responsibility to inscribe at the Registry and, in the case of Section (iii), the obligation shall correspond to both the companies in which trusts hold their stock or shares and to the trustee institutions.

The filing for registration should be within 40 working days starting from the date of incorporation of the company or participation of the foreign investment; from the formalization or notarization of the documents relative to the foreign company; or from the establishment of the respective trust or granting of trust rights in favor of the foreign investment.

The parties required to register in the Registry must annually renew their registration by presenting an economic and financial statement report (Questionnaire) under the terms established by the corresponding Regulations. The Registry is not for public consultation.

J. **Penalties.** The Ministry of Economy may revoke the authorizations previously granted in the event that the acts are committed in violation of the provisions of the FIL.
Acts, agreements, articles of incorporation or partnership agreements declared by the Ministry of Economy as being in violation of the FIL will have no legal effects between the parties nor will they have any effects before third parties.

Acts committed by persons with the purpose of facilitating the enjoyment or sale of real estate in the Restricted Zone to foreign individuals, foreign legal entities or to a Mexican company that does not have a foreigners exclusion clause, will be sanctioned with a fine up to the amount of the value of the operation.

In determining and imposing sanctions, the affected party will have a hearing. In the case of pecuniary sanctions, the nature and seriousness of the violation will be considered, as well as the economic capacity of the violator. Also, the time which elapsed between the date on which he/she was required to meet his/her obligation and its actual fulfillment or compliance, and the total value of the operation will be taken into consideration.

The sanctions mentioned in the FIL will be imposed without prejudice in light of the corresponding civil or criminal liabilities.

4. Other Permits and Registrations. In addition to the above registration requirements, the local Company will have to obtain other administrative registrations such as: i) recording at the corresponding Public Registry of Commerce; ii) registration as tax payer before Tax Authorities; iii) registration as an employer before the Mexican Institute of Social Security and the Worker’s Housing Institute; and iv) in general before other Government Agencies, federal (such as The Ministry of Economy), local and municipal, depending upon the Company’s activities.

5. Dividend or Royalty Remittances. There is no ceiling nor exchange controls on dividend or royalty remittances abroad by a company operating in Mexico.

6. Taxation. A Mexican Company will be subject to the current following taxes during its operation.

A. Corporate Tax. A Corporate Tax assessable at a maximum rate of 30% must be paid annually to the Tax Authorities on the Company’s taxable profits. The procedure to calculate such profits is by deducting certain allowed expenses from the total accruable gross income. This corporate tax rate will be reduced 1% every year, until reaching a maximum of 28% in 2007.

Most of the Company’s income is considered accruable for Income Tax purposes at the time any of the following situations occur:

1. invoices are issued;
2. when the goods are delivered to the buyer, or the services are rendered; and
3. when the total or partial amount of the transaction is collected or is payable, including advance payments.

Basically, the allowed deductions are all costs and/or expenses strictly necessary to carrying out the Company’s business. Two new deductions were added to the Income Tax Law as follows: (a) 100% of the investment in machinery and equipment for the generation of energy from renewable resources, and (b) 100% of the investment in improvements to a facility for the purpose of facilitating access and use thereof, for handicapped persons.

Except for the first year of operations, all Mexican corporations must file their income taxes through monthly provisional payments. These provisional payments will be credited against the annual Income Tax Return.
B. Tax on Assets. There is also a Federal Tax on Corporate Assets, established at a 1.8% rate. This tax will be applied on certain current assets and on fixed assets of Mexican companies and foreigner’s assets within Mexico to be transformed and returned out of Mexico, except for Maquiladoras who will not pay taxes on assets for those assets used to obtain profits. This tax will be paid on an annual basis through monthly provisional payments.

If in any fiscal year the income taxes paid by a company exceeds the tax on assets paid by such company, the taxpayer may request a refund equivalent to the amount of tax on assets paid for that fiscal year and for the previous 10 (ten) fiscal years in which the tax on assets had been paid and the taxpayer had not requested a refund.

Likewise, if in any fiscal year the tax on assets paid, exceeds the income taxes paid, the taxpayer may credit against the tax on assets the income taxes paid.

Additionally, the Tax on Assets is not due during the pre-operational period, the first three years of operation, and during the liquidation of the company unless this liquidation lasts for more than two years.

There is an option whereby the local manufacturing company can assume the tax liability of the foreigner on the assets to be transformed and as a consequence the liability on the foreigner is avoided. Through this option the local manufacturing company can credit this tax against its own corporate income tax.

C. Value Added Tax. A company doing business in Mexico will be obliged to pay Value Added Tax ("VAT") when it carries out any of the following activities:

1. alienates or leases goods;
2. renders independent services;
3. provides temporal use of goods; or
4. imports goods and/or services.

This tax shall be calculated by applying the general rate of 15% to the price of the goods or services. If residents in defined Border Areas of Mexico and some nearby cities (North America and Central America) perform the foregoing activities, the applicable rate will be 10%. The VAT is charged to the taxpayer who acquires the goods or receives the services from the Company. Therefore, the VAT must be stated separately in the invoice of the goods or services. Basically, the Company shall pay to the Tax Authorities the difference between the VAT it has transferred to its clients or paid on the importation of goods and services from the VAT the company had paid to third parties during the course of business.

However, if the Mexican company with an Export Incentive Program authorized by the Ministry of Economy (see below), definitively exports such goods or services from Mexico, and such goods or services are used entirely outside of Mexico, the VAT shall be 0% as well as all food products.

D. Special Tax on Production and Services (STPS). Anyone who carries out the following activities is subject to the STPS:

Alienation within the Mexican Territory or the importation to Mexico of the following goods and the rendering of the following services, among others: (i) certain alcoholic beverages; (ii) tobacco, cigarettes and cigars; (iii) fuel and natural gas (except for cars and trucks use); and (iv) sweeteners other than sugar, soft drinks, sodas, etc. (technical rules apply for exceptions).
Starting January 1st, 2004, the levels for categorizing alcoholic beverages increased, therefore for alcoholic beverages the tax rate was reduced from 60% to 50%.

Beginning in 2005, the following previously taxed items have been added to the exempt list, provided the only sweetener in these items is cane sugar: certain beverages, and concentrates or powders for the production of beverages (consult the Special Tax on Production and Services Law for a specific and complete list).

Taxpayers will be subject to a graduated withholding tax up to 110%, depending on the type of good or service.

E. Payroll Taxes. The Company shall be subject to a local state payroll tax which rate will depend on the location of the working facilities. On the other hand, the Federal Government also requires corporations to make social security and other labor related contributions which can amount to up to 33% of the payroll. Such contributions are as follows:

a. Social Security Contributions. Social Security contributions must be withheld and paid by an employer and remitted to the Mexican Institute for Social Security every month. Additionally, employers are required to contribute to their employees’ Social Security. Both contributions will be based on a percentage of the employees’ wages. The following rates are applicable: (i) sickness and maternity - approximately 8.75% by the employer and 1% by the employee; (ii) invalidity- 2.80% by the employer and 3.125% by the employee; and (iii) retirement fund, old age, severance pay- 5.150% by the employer and 1.125% by the employee.

b. Housing. In addition to the contributions required by the Social Security Law, the Labor Law establishes that employers must contribute to the National Worker’s Housing Institute an amount equal to 5% of the employees’ wages.

c. Premium for Occupational Risks. The employer must also pay a premium for each employee which is based on a percentage of the employee’s salary and varies according to the risk level of a particular job. Such percentages vary from 0.54% for administrative type employees to 7.5% for employees engaged in heavy industry.

Payroll fees and taxes are deductible for income tax purposes.

F. Taxation of Foreigners. Mexico’s tax treatment of income earned by foreigners is comparable to that of the U.S. and other industrialized nations.

Mexico has negotiated international tax agreements with a number of its major trading partners, such as Canada and the U.S. These agreements have two basic objectives: (i) to ensure that each Contracting State allows tax credits for income taxes paid to the other Contracting State to avoid double taxation; and (ii) to reduce the taxes that each Contracting State may impose on the nationals of the other (i.e., taxes on income from interest on loans, dividends, and royalties).


To analyze Mexico’s taxation of income earned by foreigners, this section begins with an overview of the ITL applicable to foreigners and then examines the significant provisions of the Tax Treaties concluded with the U.S. and Canada.
G. Withholding Third Party Taxes.

a. Fees for Independent Services. In case a resident company pays fees for independent services rendered within Mexican Territory by residents in Mexico a 10% tax will be withheld. In case the individual or legal entity resides abroad, but renders services within the Mexican Territory the withholding gross rate shall be of 25%.

In accordance with the provisions of the U.S.-Mexico Tax Treaty, it is established that the income of this type can only be taxed by the state of residence of the renderer of the services. Such income can be taxed by the state different from the state of residence if: (i) the party who renders services has a permanent establishment in the state different from his/her state of residence; or (ii) the staying period of the party who renders services in the foreign country different from the country of its residence exceeds 183 calendar days during any continuous twelve month period, since the party who renders services will automatically acquire residence in that other state by exceeding the mentioned limit.

b. Salaries.

i. Residents of Mexico. All salary payments for workers residing in Mexico will be subject to a withholding tax of 0% up to 30%. This withholding tax will be reduced by 1% every year, until reaching a maximum of 28% in 2007. (Note: annual income of MexCy $76,000 is exempt from taxes.) And, for workers that reside abroad, the tax shall be calculated applying the rates of the ITL.

ii. Stay in Mexico less than 183 days. However, salaries of foreign employees paid in Mexico by foreign employers that do not have a permanent establishment are exempt from the ITL, in Mexico, if the employee’s stay in the Mexican Territory does not exceed 183 calendar days, consecutive or not, in a period of twelve months.

iii. Stay in Mexico more than 183 days. On the other hand, if the employee’s stay exceeds the 183 day threshold, then Articles 180 and 182 of the ITL will apply. These articles state that when a person makes use of Mexican infrastructure and the employee’s services are being rendered in Mexican territory, then the source of income is in Mexico. These employees are liable for paying income tax in Mexico. Because the foreign employer is not a resident of Mexico, the employer may not be a withholder of the tax. It is the employee’s sole responsibility to comply with the tax filing requirements.

Section 180 of the ITL states that the first MexCy $125,900.00 of income earned within the corresponding calendar year, is exempt. Income earned between MexCy $125,901.00 and MexCy $1,000,000.00, is taxed at a rate of 15% of the gross income. And, income MexCy $1,000,001.00 and over, is taxed at a rate of 30% of the gross income.

Likewise, in accordance with the U.S.-Mexico Tax Treaty, the general rule states that the salaries, wages, and similar remunerations obtained by a person through employment, can only be taxed in the state of residence.

However, such income can be taxed by the state different from the state of residence when:

i. The employment is performed in that other state;

ii. The receiver remains more than 183 days consecutive or not in any 12 month period, since the receiver will automatically acquire residence in that other state by exceeding the mentioned limit;

iii. The remunerations are not paid by the employer that is not a resident in that other state and it does not have a permanent establishment; and
iv. The remunerations are supported by a permanent establishment of that other state.

Individuals must include in their own taxable incomes those ones received in the period by companies, entities and trusts located or resident in "low-tax jurisdictions" (tax havens), in proportion to their daily average share holding in the period, even when such income has not been distributed. This income is not considered for the purpose of advance tax payments. Authorized deductions may be taken and prior year’s tax losses may be carried forward provided that the foreign entities’ accounting records are at the disposition of the tax authorities. As with business entities, individuals must file an annual information return reporting investments held in those low-tax jurisdictions.

c. Royalties. All payments related to royalties or technical assistance are considered originated from a Mexican source of income when the benefit of the goods or services subject to the royalty payment is within Mexico.

Royalties paid for the use or exploitation of patents or certificates of invention or improvement, trademarks and commercial names, as well as advertising, are subject to a withholding rate up to 30%, to be reduced each year by 1%, until reaching a maximum of 28% in 2007.

Technical assistance and royalties different from those mentioned in the paragraph above are subject to a withholding rate of 25%.

In accordance with the U.S.-Mexico Tax Treaty, the use and temporary enjoyment of industrial drawings and models, patents, trademarks and commercial names are considered royalties. The tax on these royalties shall not exceed 10% of the gross amount thereof if the effective beneficiary is a resident of the U.S.

Likewise, the Treaty does not consider the technical assistance or transfer of technology and publicity as royalties. Therefore, those activities shall not enjoy the benefits of the Treaty, and the tax shall be calculated in accordance with the applicable laws of each state in particular, that is, 25% on royalties for technical assistance or transfer of technology, and up to 30% (to be reduced each year by 1%, until reaching a maximum of 28% in 2007) on royalties for publicity in the case of Mexico.

The ITL provides that the following requirements must be met for the payments under technology transfer or assistance or know-how to be deductible:

i. the supplier party must have proper technical elements for such purpose;

ii. the transfer of technology or know-how or assistance must be effectively performed and not merely made available, except in those cases in which payments are made to residents of Mexico and the agreement provides that the assistance or transfer shall be performed by a third party; and

iii. the services have actually been rendered.

d. Interest (financing). According to the ITL, interest payments derived from loans granted by foreign banks registered before the Mexican Ministry of Treasury, interest payments from loans granted by a foreign State’s financial entities, and interest payments to foreign entities derived from debt quoted in a stock exchange are all subject to a withholding rate of 4.9%.

The interest payments from negotiable instruments, bonds, debentures, real estate certificates, loan of securities, provided that these are placed in a stock exchange, are subject to a withholding rate of 4.9%.

In addition, if the beneficiaries of such interest payments are residents in a country which has a tax treaty with Mexico, the withholding tax rate shall be 4.9%.
If interest is paid to re-insurance companies, the rate will be 15%. If said interest payments are made to non-
registered foreign financial entities and to suppliers or lenders for the acquisition of machinery and equipment for
commercial/industrial activities in general, the withholding tax prevailing shall be 21%.

A withholding tax rate up to 30% (to be reduced by 1% each year until reaching a maximum of 28% in 2007)
will be levied on interest payments derived from situations different from those mentioned in the preceding
paragraphs.

However, if the beneficiaries of such interest payments are residents in a country that has signed a tax treaty
with Mexico, the withholding tax rate shall be 10%.

In accordance with the provisions of the U.S.-Mexico Tax Treaty, the following guidelines apply (although in
this case the ITL provides better benefits):

i. By general rule, the tax on interests is allowed in the state from which they originate;

ii. It is important to consider the debtor’s residence status;

iii. If the effective beneficiary of the interest payments resides in the U.S. or Canada, the withholding rate that
shall prevail is:

   (a) 4.9% on gross interests derived from loans granted by banks, insurance companies, negotiable
   securities in a well known stock market.

   (b) 10% on gross interests derived from loans different from those mentioned in sub-section (a) above, or
   when the debtor is a bank or the buyer of machinery and/or equipment.

   (c) 15% on gross in all other cases.

iv. If the effective beneficiary of the interest payments performs or has performed entrepreneurial or
professional activities by means of a permanent establishment in Mexico from which such interest
payments derive, the interest payments mentioned in sub-section (a) and (b) will not apply.

e. Dividends. Dividends are subject to a special tax treatment. The main objective of the ITL regarding this
matter is to avoid tax burdens on dividends that have already been levied with income tax. For this purpose, a "net
profit account" has to be determined every time a Company pays dividends or when the year’s fiscal profits have been
determined. In general terms, profits net from income tax, profit sharing and non-deductible expenses, increase the
"net profit account," and the payment of dividends reduces the account.

If the amounts of dividends to be paid exceed the "net profit account," the excess is levied up to 30% rate,
dividends paid which do not exceed the "net profit account" are levied at 0%. However, due to a gross up of the
income tax in the operation, the beneficiary receives the total amount of dividends and the Company absorbs the tax
burden.

However, under the U.S.-Mexico Tax Treaty, this rate is 10%. Even though this is arguable, the Ministry of
Treasury applies the treaty rate. Profits or money remittances to the parent company abroad are subject to up to the
30% rate provided that such profits or remittances do not come from the "net profit account," "reinvested net profit
account," or "capital remittances account."
If the foreign individual or entity receiving dividends is a resident in a low-tax jurisdiction (tax havens) the withholding rate will be 40%.

The ITL also defines dividends as any amount received by the partners of an "Association in Participation" from the managing partner thereof.

In general terms, according to the U.S.-Mexico Tax Treaty, if the effective beneficiary of the dividends is a resident in the US, the withholding tax rate shall not exceed the following:

(a) 5% levied on the gross amount of dividends if the effective beneficiary owns at least 10% of the shares of the capital stock with voting rights.

(b) 10% levied on the gross amount of dividends in all other cases.

The above mentioned will not apply if the beneficiary of the dividends performs or has performed entrepreneurial activities by means of a permanent establishment in Mexico and such dividends derive from the permanent establishment. If this is the case, the tax treatment that would prevail would be based on the Company’s profits from such permanent establishment.

f. Tax Havens. Individuals must include in their own taxable incomes those ones received in the period by companies, entities and trusts located or resident in "low-tax jurisdictions" (tax havens), in proportion to their daily average share holding in the period, even when such income has not been distributed. This income is not considered for the purpose of advance tax payments. Authorized deductions may be taken and prior year’s tax losses may be carried forward provided that the foreign entities’ accounting records are at the disposition of the tax authorities. As with business entities, individuals must file an annual information return reporting investments held in those low-tax jurisdictions.

It is important to note that due to ITL 2004 amendments, the definition of a tax haven has changed. Previously, there existed a set list of jurisdictions which were considered tax havens. Although this list still exists, per the amendments, income fitting the following criteria must be declared as originating from a tax haven jurisdiction (régimen fiscal preferente):

i. That income which is not taxed in such a jurisdiction, and

ii. That income which is taxed at a rate of 75% or lower than it would have been taxed in Mexico.

Additionally, income which is generated in a foreign country which, despite having a tax treaty in place with Mexico may be lacking a free exchange of information clause within the treaty, may be considered as originating from a tax haven jurisdiction.

H. Lease of Real or Personal Property. Non-residents’ income derived from the lease of real or personal property is taxed at a flat rate of 25% with no deductions, except for the lease of railroad cars, containers, airplanes, and ships for commercial transportation, which is taxed at 5%.

I. Capital Gains. Gains from the sale of shares or securities representing property located in Mexico, fixed assets, securities, or shares of Mexican companies are taxed at a flat rate of 20% of the gross proceeds of the sale. However, the non-resident may elect to pay tax at the rate of 25% on the net taxable gain realized, provided that the non-resident has a legal representative in Mexico, who will calculate and pay the corresponding tax to the tax authorities. If the seller is a resident of a low-tax jurisdiction (tax haven), such seller can only apply the 25% rate.
J. Joint Liability of Withholder. Any company resident in Mexico or a permanent establishment in Mexico, must comply with the withholding and payment of taxes on behalf of third parties. If such taxes are not withheld and paid to the Tax Authorities, aside from imposing surcharges and penalties on the Company, the latter is not authorized to deduct them as expenses for Income Tax purposes.

K. U.S.-Mexico Income Tax Treaty. The U.S.-Mexico Tax Treaty reduces the taxation of investment income flowing between the two countries. The Treaty includes provisions designed to prevent double taxation and to reduce each country’s tax rates on various types of income earned by nonresidents. Note that the Treaty applies only to income taxes and does not cover sales taxes (i.e., the Mexican Value-Added Tax), social security taxes, etc. The following is a summary of the key provisions of the Treaty.

   a. Residence/Permanent Establishment. The U.S.-Mexico Tax Treaty provides extensive definitions of the terms "residence" and "permanent establishment" to clarify each country’s rules for the taxation of nonresidents (mentioned above).

   b. Royalties. The U.S.-Mexico Tax Treaty has lowered Mexico’s withholding tax on royalties to a flat rate of 10%.

   c. Dividends. The Treaty has also lowered the US withholding tax (equivalent to the ITL) on dividends paid by US companies to Mexican residents to 5% or 10% depending on the interest in the company.

   d. Related Parties (transfer pricing). In order to avoid tax evasion through transactions between related parties (e.g., a U.S. parent corporation with a Mexican subsidiary), the Treaty authorizes the Contracting States to tax such enterprises on any profits that would have been obtained if the transaction were conducted between non-related parties in an arm’s length transaction.

   e. Asset Tax. Although the U.S.-Mexico Tax Treaty does not apply to the Mexican Asset Tax, it assures that U.S. companies will not lose the benefits of the Treaty through application of the Asset Tax. Mexico will apply the Asset Tax to U.S. companies only on income from royalties, real estate, or a permanent establishment in Mexico. In those cases, Mexico will grant a tax credit to compensate for any benefits lost from the Treaty (see U.S.-Mexico Tax Treaty, Protocol No. 3).

   f. Charitable Organizations. Mexico and the U.S. have agreed not to tax religious, scientific, literary, educational, or other charitable organizations that are residents of the other country if such organizations are exempt from taxation in that other country. In addition, both Countries will allow the deduction of charitable contributions made to qualifying organizations of the other country.

   g. Dispute Resolution. Under the U.S.-Mexico Tax Treaty, residents of the U.S. and Mexico are able to challenge violations of the Treaty through each country’s legal system or the Treaty’s "Mutual Agreement Procedure," which provides for consultation between the competent authorities of each country to resolve the dispute. If the competent authorities cannot resolve the dispute, the Treaty provides for binding arbitration upon the consent of both the taxpayer and the government authorities.

   h. Other Provisions. The Treaty clarifies ambiguities with regard to shipping and air transportation, income from real property, visiting artists and athletes, government employees, students, and income from pensions, annuities, alimony, and child support.

The Treaty also contains a special provision which extends the benefits of the Treaty to entities owned by residents of NAFTA Parties, even if the particular entity does not satisfy the Tax Treaty’s residency requirements.
Finally, the Treaty provides for the exchange of information and cooperation between the tax authorities of Mexico and the U.S. for the purpose of preventing tax evasion. These provisions incorporate and expand upon a prior treaty concluded between the U.S. and Mexico for the exchange of tax information (Convention between the U.S. and the United Mexican States for the Exchange of Information with Respect to Taxes, signed on November 9, 1989, effective January 18, 1990, reprinted in "Highlights and Documents," H&D International Tax, November 15, 1989, at 1635).

L. **Canada-Mexico Income Tax Treaty.** A bilateral income tax treaty has been in effect between Canada and Mexico since July 17, 1992. Like the U.S.-Mexico Tax Treaty, the Canada-Mexico Tax Treaty provides for avoidance of double taxation, reduction of income taxes applied to foreign residents, and the exchange of information between government authorities to avoid tax fraud.

The Canada-Mexico Tax Treaty is virtually identical to the U.S.-Mexico Tax Treaty, except for the following differences:

a. **Dividends.** While the U.S.-Mexico Tax Treaty reduces U.S. taxes on dividends to a rate of 5% or 10% (see above), the rate between Canada and Mexico will be 10% or 15%.

b. **Interest.** Canada and Mexico have agreed that the highest tax rate on interest income earned by non-residents will be 15%. Under the U.S.-Mexico Tax Treaty, the tax rates are 4.9%, 10% and 15% depending on the type of loan.

However, according to the Most-Favored-Nation Provision of the Canada-Mexico Tax Treaty, if either country includes a lower tax rate on interest in a tax treaty concluded with another country, that tax rate will apply to the Canada-Mexico Tax Treaty, but **under no circumstances** shall the rate be lower than 10%. Consequently, upon ratification of the U.S.-Mexico Tax Treaty, the same tax rates on interest applied between Canada and Mexico, except that 10% will be the lowest tax rate—versus 4.9% (see Canada-Mexico Tax Treaty, Protocol).

c. **Royalties.** The Canada-Mexico Tax Treaty’s maximum tax rate for royalties earned by foreign residents is 15%. The U.S.-Mexico Tax Treaty applies a maximum 10% rate. Therefore, in compliance with the Protocol described in the preceding paragraph, the maximum 10% rate will also apply to royalties between Canada and Mexico.

d. **Dispute Settlement.** The "Mutual Agreement Procedure" of the Canada-Mexico Treaty is identical to that of the U.S.-Mexico Tax Treaty, except that Canada and Mexico did not provide for binding arbitration.

e. **Other Provisions.** In addition to the foregoing differences, the U.S.-Mexico Tax Treaty has a series of provisions that are not included in the Canada-Mexico Tax Treaty, such as rules regarding the taxation of branches, alimony and child support, and exempt organizations.

7. **Labor Regulations.** Labor relationships are established, regardless of the existence of a written labor agreement, when there is an employer-employee relationship which has the elements of subordination and dependency. In general terms, subordination means the employee follows the directions and engages in the activities of the employer, and dependency means there is an element of economic dependency upon the employer.

Furthermore, and regardless of any agreement to the contrary, under the Labor Law, commercial agents or sales promoters and other similar agents, are considered employees of the company for whom they render their services when their activity is permanent, unless they do not personally perform the work or only participate in isolated operations.
Once the labor relationship is established, the whole set of provisions of the Labor Law and others derived therefrom (such as the Social Security Law and the Workers Housing Fund Institute Law) will apply to both the employer and the employee, and the employee may not waive them.

The Labor Law states the minimum rights of employees. However, a labor agreement will be essential to define the rights and obligations to which both the employer and employee will be subject, that is, the employment terms (i.e., schedules, work place, scope of employee's activities, confidentiality obligations, etc.).

The Labor Law also applies to those employees who are foreign nationals, hired by a foreign entity, who reside abroad, but work in Mexico for more than 183 days within a 12 month period. In this situation, the employee is solely responsible for registering with the Mexican tax authorities, obtaining a tax ID, and filing monthly and annual tax returns. If the employee fails to comply with the law, penalties and surcharges will be incurred. The foreign employer will not be jointly liable. Note that in these cases, the foreign entity will also be held as an "employer" for labor-related obligations. This situation is very common in border areas between Mexico and the U.S.

A. Daily Wage and Fringe Benefits. Under the Labor Law an employee should receive at least a minimum general daily wage (which equals approximately U.S.$4.50) and minimum statutory fringe benefits. In practice, hardly any employer pays as low as the minimum daily wage.

With respect to fringe benefits, they include: (i) annual vacation: at least 6 working days to be compensated at 125% of salary per day; (ii) annual bonus of at least 15 days of salary; (iii) profit sharing: 10% of pre-tax earnings to be distributed among employees other than certain high officers; and (iv) variable payroll contributions for Social Security (IMSS), Workers Housing (INFONAVIT), and Retirement Fund (AFORES).

NOTE: Beginning with income generated in 2005 (to be claimed in 2006), the compulsory profit sharing figure shall become a below the line deduction. The 2004 ITL amendment is careful in pointing out that this deduction is NOT an "authorized deduction" (above the line), and may NOT be used to reduce gross income.

Social Security contributions go up to 22.57% based on the payroll salary, and Workers Housing contributions are of 5% on the payroll salary, and Retirement Fund contributions depend upon the payroll salary and the commissions charged by the AFORES "Retirement Fund Administrators."

B. Severance Payments. The mandatory severance payments in case of termination of labor relationships are based on the current daily salary of the employee. The concept of salary takes into account any type of premium, bonus, commissions or any other payment that the employee is entitled to receive from the employer, both in Mexico and abroad, derived from his/her labor relation including additional economic benefits provided by the employer, such as, a car, club fees, etc.

If the employee is compensated on the basis of commission for his/her services, to determine the daily salary from such commission, the total monies received from commissions in the last calendar year for such services will be divided by 365, or if the employee worked for less than a year the monies received will be divided by the actual period worked.

C. Types of Termination. For the payment of severance benefits a distinction is made between: (i) a termination without or with fair cause; and (ii) termination by mutual agreement. The indemnification rights that an employee could claim are different in each case.

a. Termination without Fair Cause. Employees may be dismissed with or without "fair cause," as statutorily defined. The term "fair cause" is narrowly defined basically to include only significant violations by employees of employment terms to the detriment of the employer.
In the event of dismissal without fair cause, the terminated employee will, at his/her option, have the right to:

i. Demand reinstatement, unless he/she is a trusted employee ("empleado de confianza"), in which case he/she will only receive payment of certain termination indemnities as discussed in (ii) below. The Labor Law defines trusted employees in the context of their responsibilities given the nature, importance and confidence of his/her services and his/her relation with the employer. Sales agents, for example, are considered trusted employees.

ii. A trusted employee not reinstated will be entitled to receive:

(a) Three (3) months of salary;
(b) Twenty (20) days of salary for each year of employment;
(c) Seniority premium equal to twelve (12) days salary per year of employment;
(d) Proportional share of vacation, annual bonus, and profit sharing for the year in which the employment was terminated; and
(e) Salaries accrued from the date of termination to the date of payment of indemnities.

b. Termination with Fair Cause. A company could dismiss its employee at any time based on a fair cause. In such case, the employee, as trusted employee, can ask for the following accrued rights:

i. Proportional share of vacation, annual bonus, and profit sharing, for the year in which the employment was terminated;
ii. Salaries accrued from the date of dismissal until the payment of the indemnities;
iii. Seniority premium equal to twelve (12) days salary per year of employment; and
iv. If at trial the employer cannot prove the cause of rescission, a trusted employee will also have the right to the salaries accrued from the date of rescission to the date in which the award is fulfilled ("salarios caídos"), together with 3 months of salary, and 20 days of salary for each year of employment.

c. Termination by Mutual Agreement. A termination by mutual agreement finalizes a labor relation without the fault or breach of obligations by any of the parties. In this case, the employee will be entitled to the following accrued rights:

i. Proportional part of the following payments for the year during which the employment was terminated, calculated as follows:

(a) Vacation: at least 6 working days to be compensated at 125% of salary per day;
(b) Annual Bonus: at least 15 days of salary;
(c) Profit Sharing: 10% of pre-tax earnings of the company to be distributed among all employees depending upon the number of days worked in the year and the amount of salaries received in such year; and

ii. Seniority premium in the amount of twelve (12) days of salary per year of service, provided that the employee has completed 15 (fifteen) years of employment.
Experience has shown that an employee will typically not consent to a mutual termination unless the employer is willing to pay an additional termination indemnity. Depending on the circumstances, such indemnity is usually less than what the employee would have received under a termination without fair cause.

A termination agreement to be entered into with the employee should be ratified by the local Labor Arbitration Board. If the agreement is not ratified, theoretically such agreement could be open to challenge by the employee arguing unfair dismissal.

8. Immigration.


Under the Immigration Act foreigners may legally enter Mexico either as "Non-immigrants" on a temporary basis, or as "Immigrants," with the intention of living in Mexico indefinitely or obtain citizenship. In either case, the foreigner must have permission from the Ministry of the Interior before entering Mexico.

a. Non-immigrant (temporary entry). Foreigners may enter Mexico temporarily with the migratory status of Non-immigrants, whether as tourists (for travel or health), as visitors (to conduct business, investment, scientific, technical, artistic, or athletic activities, or to work for a Mexican company), or as directors (being members of the board of directors of a Mexican company). The time period in Mexico and the conditions for the granting of the Non-immigrant migratory status varies with the activity that the foreigner wishes to engage in while in Mexico. The following is a description of the various ways in which a foreigner can enter Mexico with the Non-immigrant migratory status.

i. Tourist. By far the most common method of entry into Mexico is the tourist card (form FM-T), which is available at Mexican Consulates, Tourist Offices, or most airlines. A tourist card entitles a foreigner to visit Mexico for up to 6 (six) non-extendable months, except in the case of an illness making it impossible for the tourist to leave Mexico or on account of other duly proven exceptional circumstances. In such cases, the tourist will be granted an additional extension until he/she is able to leave.

Although business people commonly use the tourist card to enter Mexico, they are technically entering the Country illegally and could be expelled from the Country by the Government Authorities during their visit to Mexico. A tourist is not legally allowed to perform activities different from travel or health. As a tourist, the foreigner cannot buy real estate or enter into long-term leases, nor engage in any business conversations or endeavors of any kind although, as a practical matter, occasional business conversations will not pose a problem.

A tourist may bring to Mexico only personal items associated with pleasure travel, e.g. cameras, sporting goods, personal jewelry, etc. A tourist may also bring an automobile into Mexico without paying import duties, provided that the tourist obtains a permit and does not leave the country without the vehicle.

ii. Visitor. Foreigners may enter Mexico temporarily as visitors (form FM-3) for a period of up to 1 (one year) to conduct business, investment, scientific, technical, professional, artistic, academic, or athletic activities, or to work for a Mexican company in a "position of trust." A visitor is allowed multiple exits and entries, and may extend his/her stay in Mexico for 4 (four) additional periods of 1 (one) year each.
Mexican consulates abroad are authorized to issue "Modified Tourist/Business Visas" to business people. While not specifically described in the Immigration Act, these Business Visas can last for up to 6 six months with multiple exits and entries. However, they are generally granted for a period of 30 days.

Foreigners may work in Mexico as "Non-immigrant visitors" if they demonstrate to the Mexican authorities that: (i) a Mexican company, institution or person is requesting his/her services in Mexico; and (ii) his/her capacity to provide such services in Mexico. In all such cases, the foreigner must demonstrate to the Mexican authorities the availability of sufficient economic resources to support him/her during his/her stay in Mexico. This usually entails a notarized letter provided by a bank attesting to the fact that such visitor will have enough monthly income as determined on a case by case basis by the Ministry of the Interior.

A visitor can bring his/her personal furniture and furnishings into Mexico. The visitor’s dependents may apply for the migratory status of "Non-immigrant-family-visitors," whose status can be renewed without leaving Mexico when the visitor renews his/her own papers, or they may enter as tourists, subject to the inconvenience of having to leave Mexico at least every 6 (six) months to renew the tourist card.

A foreign Non-immigrant Visitor directly employed by a Mexican company must be included in the company’s payroll and is subject to Mexican income tax on his/her salary.

The Non-immigrant Visitors Card can be obtained in Mexico directly from the Ministry of the Interior or through a Mexican Consulate abroad. In either case, it is advisable to seek the assistance of Mexican lawyers or other immigration experts to submit the Non-immigrant Visitors Card application to the Ministry of the Interior.

If the Card is obtained through a Mexican Consulate abroad, such Consulate shall issue the Card once the Ministry of the Interior authorizes it (usually within six or eight weeks of the application) and sends the documents to the corresponding Consulate. Thereafter, the Consulate shall deliver the Card to the applicant upon presentation of certain documents and payment of the appropriate duties.

The Card may also be obtained during the visit of the foreigner as a Tourist in Mexico, having to deliver his/her Tourist Card when filing the application to change his/her migratory status to the Ministry of the Interior. Once the Ministry of the Interior authorizes the Card, it will request the foreigner appear before the immigration authorities to sign the document, pay the corresponding duties and receive the document personally.

iii. Director/Board Member. With the migratory status of non-immigrant director, a foreigner (member of the Board of Directors of a Mexican corporation) may enter Mexico to attend shareholders’ or board of directors’ meetings. The Card is issued upon the presentation to the Ministry of the Interior of a document attesting to such foreigner’s appointment as a director/board member by a shareholder’s meeting. Such Cards are issued for a period of up to 1 (one) year, with up to four extensions for additional 1 (one) year periods, with multiple exits and entries to the country. However the foreigners maximum stay during each visit is 30 (thirty) days.

b. Immigrants and Permanent Residents (intention to stay). A person who intends to live in Mexico on an indefinite basis and obtain residence rights should first obtain the migratory status of "Immigrant" (FM-2). After living in Mexico for 5 (five) years and complying with the conditions under which the migratory status of Immigrant was granted to him/her, the foreigner can apply for the change of migratory status to Permanent Resident ("Inmigrado") status. The foreigner with the migratory status of Permanent Resident ("Inmigrado") may reside permanently in Mexico, enjoying many of the rights enjoyed by Mexican nationals.
Foreigners may enter Mexico as Immigrants provided that the foreigner complies with the requisites applicable to the migratory characteristic her/she wishes to obtain. The migratory characteristics of the Immigrants are:

i. **Retiree (Rentista).** A retiree is a foreigner who lives in Mexico on his/her own resources from abroad; on the interests derived from his/her capital investments in Government certificates, securities, etc. or of credit institutions or others designated by the Ministry of the Interior, or on any other permanent income from abroad. This Card shall be granted, provided that the monthly income from abroad is enough for him and his family (as applicable). the Ministry of the Interior determines, from time to time the amount considered as "enough."

ii. **Investor.** An investor is a foreigner who invests his/her capital in Mexico's industry, commerce and services in accordance to applicable Laws. The investment may consist of stock, shares, participation certificates, fixed assets or trust beneficiary rights. This Card shall be granted, provided that such investment contributes to the economic and social development of Mexico and the amount established by the Ministry of the Interior remains invested during the time the foreigner resides in Mexico. To maintain this Card, each year the foreigner must prove to the Ministry of the Interior that he/she has maintained the amount invested as established by the Ministry of the Interior. The amount required by the Ministry will be re-established periodically.

iii. **Professional.** A professional is a foreigner that may enter Mexico to practice their profession in extremely narrow circumstances. A foreigner may practice his/her profession in Mexico, provided that the professional degree has been registered with the Mexican authorities and obtained the corresponding credentials ("cédula") to practice his/her profession.

iv. **Position of Trust.** A person in a position of trust is a foreigner that, as sole administrator, assumes the managerial duties in companies or institutions established in the Mexican Republic, provided that, by the Ministry of the Interior’s decision, there is no duplication of duties, and the services to be rendered merit the entry of the foreigner to the country. This Card must be requested by an established Mexican company or institution, which shall be responsible for the foreigner’s activities before the Ministry of the Interior.

v. **Scientist.** A scientist is a foreigner that leads or performs scientific investigations, teaches his/her scientific knowledge, trains investigators or performs educational services, provided that such activities are performed to foster the educational development of Mexico. The foreigner must prove to the Ministry of the Interior that he/she has sufficient capacity in the scientific activity he/she intends to perform. Likewise, the Ministry of the Interior, in its discretion, may request that the foreigner train at least three Mexican nationals in his/her field of knowledge.

vi. **Technician.** A technician is a foreigner that performs investigations applicable to production or that performs technical or specialized functions that cannot, as determined by the Ministry of the Interior, be rendered by residents. The application for this Card must demonstrate to the Ministry of the Interior the need for the use of the technical or specialized services. The rendering of the services contract or the transfer of technology agreement for the request of technical support to a foreign company must be attached to the application. Likewise, the Ministry of the Interior, in its discretion, may request that the foreigner train at least three Mexican nationals in his/her field of knowledge.

vii. **Dependant.** A dependant is a foreigner who is economically dependent on a husband or wife or a direct blood relative in straight (vertical) line without limit of degree, or horizontally up to the second degree whether Immigrant, Permanent Resident (Inmigrado) or Mexican national. The children and brothers of the applicants can only be admitted with this migratory characteristic when they are minors (less than 18 years of age), except when they have a duly proven impediment to work or are studying.
The application for this Card shall be presented by the person who will support such dependants. This same person must also prove his/her Immigrant or Permanent Resident (Inmigrado) Status or his/her Mexican nationality and his/her economic solvency which shall be sufficient to support his/her dependants, as determined by the Ministry of the Interior.

viii. **Artist or Athlete.** An artist or athlete is a foreigner that performs artistic or athletic activities or the like, provided that such activities contribute to the artistic creativity and/or the diffusion of athletics, and such activities are beneficial to the country, as determined by the Ministry of the Interior. This Card can be requested by any company, institution or association or by the foreigner him/herself.

During the first year with the migratory status of Immigrant, they are entitled to bring into Mexico free of duties all normal household belongings. Only the foreigners with the migratory characteristic of Retirees mentioned in item (i) above, may bring automobiles into Mexico without posting a bond to guarantee payment of import duties, but are subject to restrictions similar to those imposed on tourists (e.g., they cannot sell the car).

Immigrants may buy real estate in Mexico with the prior written permission from the Ministry of Foreign Affairs, provided that the property is not located in the "Restricted Zone," where the Mexican Constitution prohibits land purchases by foreigners. Foreigners may lease property within the Restricted Zone, but only for periods of less than 10 years. The Restricted Zone is the strip of 100 kms. along the border of the Mexican Territory and the strip of 50 kms. along the Mexican coasts.

Different from the application for non-immigrant status, the application for Immigrant status should be made in Mexico at the Ministry of the Interior. The applicant should expect to wait at least 6 (six) to 8 (eight) weeks once the file is completed with all the necessary documents submitted at the Ministry of the Interior. Immigrant status must be renewed annually.

Within 6 (six) months after the foreigner has completed 5 (five) years with the Immigrant migratory status, the foreigner can apply for the change of his/her migratory status to a Permanent Residency ("Inmigrado") status in Mexico. As a Permanent Resident, the foreigner is no longer required to obtain annual renewals of his/her immigration status and is free to work in any position open to foreigners, provided that the foreigner gives the corresponding notices to the Ministry of the Interior. A permanent resident is free to do virtually anything that a Mexican national can do with a few narrow exceptions, such as owning land in the Restricted Zone or voting. A permanent resident may be outside of Mexico for up to 3 (three) consecutive years, or five out of any ten years, without losing his/her Resident status.

**B. NAFTA Chapter 16: Temporary Entry of Business Persons.** In light of their preferential commercial relationship, NAFTA Parties have agreed to establish expedited and transparent procedures to facilitate, on a reciprocal basis, the temporary entry of business persons. Canada and the U.S. included similar provisions in the Canada-U.S. Free Trade Agreement, which allows temporary entry of business persons of the two Countries without a visa. While NAFTA Chapter 16 allows Parties to retain their existing visa requirements, its objective is the eventual elimination of visa requirements for most types of business persons. However, the actual impact of NAFTA on the immigration laws of the Parties will be unclear until specific regulations are adopted by each Party in compliance with Chapter 16.

Following the provisions of NAFTA, the National Institute of Migratory Services of Mexico created a business visa called "FM-N." This migratory form allows business people from Canada and the USA to stay in Mexico for up to 30 calendar days to perform business activities, without obtaining any other permit or migratory form. If the business people need to stay longer or will stay in Mexico for more than 1 year, they can apply for an FM-3 as described above.
However, with this FM-N migratory form, the FM-3 will be granted in a shorter period of time (around 5 working days) if all of the requirements are satisfied. The beneficiaries of this FM-N are described in item (a) below.

It is important to note that Chapter 16 applies only to temporary entry and will not affect the procedures for obtaining permanent residence in any of NAFTA countries.

a. Four Categories of Business Persons. In accordance to NAFTA’s Chapter 16, "Business Persons" are nationals of the three NAFTA Countries (the "Parties") who trade in goods or services or carry out investment activities. NAFTA divides Business Persons into 4 (four) categories of individuals whom the Parties agree to admit on a temporary basis.

i. Business Visitors. A business visitor is a person engaged in international business activities, such as research and design; cultivation, manufacture, and production; marketing; sales; distribution; after-sales service; and various other general services (see Appendix 1603.A.1 of NAFTA). Most business travelers will fall into this category, as it applies to persons who enter for a limited time to oversee business operations, attend meetings, sell products or services, or service products sold in the country. The visitor’s salary must come from outside of the country visited as opposed to employment within that country.

Under the terms of NAFTA’s Chapter 16, each Party is required to admit business visitors provided that they give proof of their nationality to the authorities of the country to be visited (being that of one of the Parties), the activity to be conducted, and that their salary is paid by a source outside of the country visited. While each Party already provides for short-term business entry (e.g., Mexico’s Modified Business/Tourist Visa as described above), Appendix 1603.A.1 specifies the broad range of activities that business visitors may carry out.

ii. Traders and Investors. Business Persons will be allowed temporary entry to trade in substantial amounts of goods or services between their home country and the country they wish to enter. This category also allows the entry of persons who have invested, or are in the process of investing, substantial amounts of capital in the country they wish to enter. Such temporary entry will be permissible for so long as such business person complies with the existing immigration measures applicable to temporary entry.

iii. Intra-company Transfers. Each Party to NAFTA will permit the entry into their country of transfers who are managers, executives, or other persons with specialized knowledge, and are employed by a company that has a branch, subsidiary, or affiliate in the host Party and in another Party. Such temporary entry will also be permissible for so long as such business person complies with the existing immigration measures applicable to temporary entry. The transferee must be citizen of a Party and must have worked for the company for at least a year before the transfer.

While expedited border processing is available to intra-company transfers between Canada and the U.S. under the FM-N, Mexico may still require a visa. It is expected that eventually Mexico will also establish procedures for expedited border processing of intra-company transfers from Canada and the U.S.

iv. Professionals. The provisions of NAFTA’S Chapter 16 also provide for temporary entry of Business Persons who wish to perform activities at a professional level provided that they satisfy minimum educational and/or experience requirements. Such temporary entry will also be permissible for so long as such business person complies with the existing immigration measures applicable to temporary entry. Except for this one, maximum numerical quotas are prohibited in all categories of Business Persons.

As described above, Mexico currently issues Non-immigrant visas to visiting professionals in narrow circumstances. NAFTA should make such visas available to a broader range of professionals and, over time, eliminate the visa requirement altogether.
b. Additional Provisions Regarding Temporary Entry. The Parties have also agreed to publish and make available statistical information regarding temporary entry of Business Persons under NAFTA and explanatory material regarding temporary entry requirements. The Parties will also attempt to reduce fees to the actual cost of processing applications and to provide written explanations of the reasons for denying entry both to the Business Person affected and to his/her home country. Finally, the Parties will form a Temporary Entry Working Group to meet annually to discuss the application of Chapter 16 provisions and the improvement of temporary entry procedures in each country.

The general dispute settlement mechanisms of NAFTA Chapter 20 (conciliation, mediation and tri-national panels) will only apply to the temporary entry provisions of Chapter 16 if the practice is recurring and the affected person has exhausted all available administrative remedies.


The Law of Acquisitions refers to acquisitions and leases of personal property and services to Government entities. If Government entities want to lease or acquire real estate, the agreement will be ruled by the Civil Law.

The Law of Public Works rules public works performed by Government entities through third parties, as well as services related thereto (e.g., paving, road repair, etc.).

The Law of Acquisitions and the Law of Public Works apply to entities and agencies of the Federal Government and to the States of the Mexican Republic (when they use Federal funding). When the States use their own funding, the acquisitions, leases and public works are ruled by the corresponding local statutes.

B. Contracting Procedure. Government contracting may be performed through 3 procedures: (i) public bidding, (ii) restricted bidding, and (iii) direct award of contracts.

a. Public Bidding. This is the most common procedure by which Government entities enter into contracts. In the case of the Federal Government, the Government publishes the Call to the Public Bidding in the Official Federal Gazette containing the requirements necessary to obtain the corresponding Contract. In order to participate in the bidding process, a contractor must purchase the "guidelines and requirements" of a particular bid ("bases de licitación"). Generally, certain conditions appear in the "bases" of the corresponding bid as follows:

i. Payment receipt of the corresponding "bases";

ii. Document evidencing the good standing of the entity that is participating;

iii. Official identification of the legal representative of the entity participating in the Bid, or of the participant if he/she is an individual;

iv. Powers for acts of administration, acts of ownership or special power of the legal representative of the participant entity to participate in Biddings;

v. Evidence of the domicile;

vi. Resume of the participant (entity or individual);
vii. Audited Financial Statements corresponding to the last Fiscal Year; and

viii. Copy of the tax return corresponding to the last fiscal year, whether entity or individual.

After the Call, participants must file their technical and economic proposals. Government entities will award the corresponding Contract based on their criteria for the corresponding type of Bidding and on the best proposal.

Participants in public biddings must guarantee: (i) compliance with all obligations acquired under the awarded Contract, and (ii) accurate use of the payments received in advance.

If no proposals meet with the requirements published by Government entities, they may Call a second Bid.

Public Bids may be: (i) domestic, or (ii) international. In Domestic Bids only Mexican citizens may participate and the goods that will be acquired shall be produced in Mexico having at least 50% of domestic content.

In International Bids, individuals or entities of any nationality may participate and the goods may be produced in Mexico or abroad. International Bids can only be performed when:

i. It is mandatory according to international treaties;

ii. No Mexican providers can offer the products or works as requested;

iii. A National Bid is called and no proposals are filed, or if such proposals do not meet the requirements; and

iv. The acquisition of the goods or the project will be financed with credits from abroad granted to Federal Government.

Also, participation of foreigners in international bids may be denied when no international treaty was entered into with the Country of origin of such foreigner or if such Country does not grant reciprocal treatment to Mexican providers or goods.

b. Restricted Bidding and Direct Award. In certain cases, Government entities may not call for a public bid but through an invitation to at least three individuals or, a direct award of the corresponding Contract. Such cases are, among others, the following:

i. When the corresponding Contract may only be entered into with a specific person since he is the holder of copyrights, patents, trademarks, or other kind of exclusive rights;

ii. When social order, economy, public services, security or environment are in danger due to an act of God;

iii. When there are circumstances that may cause losses or additional costs;

iv. When the acquisitions, leases or public works are only for military purposes or for the army, or are necessary to guarantee the security of the Country; or

v. When due to force majeure or Acts of God, it is not possible to obtain goods or services through the Bidding procedure in the required time.
Invited individuals/entities must file their technical and economic proposals, from which the corresponding Government entity will choose the best option.

C. Penalties for Providers. Penalties may apply in case that providers do not timely comply with the obligations acquired under the corresponding Contract. Such penalties shall not exceed the amount of the performance bond of the Contract granted by the provider.

Also, in case of breach, Government entities may terminate the corresponding Agreement without any liability.

D. Claiming Procedure. If any of the participants in a Public Bidding does not agree with the result of the Bid or considers that any act during the Bidding procedure was illegal, he may file a claim before the Ministry of Comptrollership and Administrative Development (the "Comptrollership").

If the Comptroller deems it convenient, it will perform an investigation to determine if the Bidding procedure was legal.

Thereafter, the Comptroller shall issue the corresponding resolution where it may: (i) declare null the irregular act or acts during the Bidding procedure; (ii) declare null all the Bidding procedure, or (iii) declare that the claim was unlawfully filed.

Also, awarded contractors may file a claim before the Comptrollership due to the breach of the terms and conditions agreed in the contracts entered into with Government entities.

E. Limitations of Proposals. The Law of Acquisitions and the Law of Public Works establish that Government Entities may not receive proposals nor enter into any contract with, among others, the following individuals:

1. Those with whom the public officer in charge of awarding shares a personal, familiar or business interest or relationship;

2. Public officers;

3. Those with whom a Government Entity previously rescinded more than one awarded contract due to their fault;

4. Providers delaying delivery of the goods or rendering the services subject matter of the corresponding Contract; and

5. Individuals declared in bankruptcy.

The Public Officers Responsibilities Law also establishes that a public officer may not participate in a Bidding to award a Contract (the "Procedure") if he/she has any interest in such business or if he/she or a relative of him/hers will obtain an economic benefit thereof.

If the public officer participates in the Procedure, however, he will have administrative liability, with sanctions such as: (i) admonition, (ii) suspension from his position from 3 days to one year, or (iii) disablement to perform any activity in the government from one to twenty years, depending on the benefit obtained from his participation in the Procedure; including the possibility of permanent removal from his position.

Additionally, if the public officer obtains an economic benefit from the awarded contract, an economic penalty will be applicable in an equivalent to three times the benefit obtained.
The public officer may also be subject to civil and/or criminal liability arising from his/her participation in the Procedure, so this liability will be determined in separate procedures.

10. Antitrust. The Mexican Federal Law of Economic Competition (the "Antitrust Statute") was published in the Official Federal Gazette on December 24, 1992 and became effective on June 22, 1993. The Antitrust Statute is part of the set of comprehensive legislation that the Mexican Government has been introducing to open and modernize the economy since 1986 when Mexico entered into the GATT.

A. Constitutional Provisions for Antitrust. Notwithstanding, Mexico has had antitrust and unfair competition laws for more than 75 years. The Mexican Constitution, promulgated early in the twentieth Century, banned trusts and unfair competition practices. The first piece of antitrust legislation was published and enacted on August 31, 1934 ("Ley Orgánica del Artículo 28 Constitucional en Materia de Monopolios"). However, in practice this legislation was never enforced.

B. Free Trade Agreement Provisions. NAFTA provides for measures to preserve free competition in the economy (NAFTA, Chapter 15 - Competition Policy, Monopolies and State enterprises - Arts. 1501-1503).

NAFTA obligates the U.S., Canada and Mexico to "adopt or maintain measures to proscribe anti-competitive business conduct...." However, it recognizes the right of each Party to designate or maintain certain private or governmental monopolies, but each Party agrees to limit its anti-competitive impact on the economy.

C. Drafting and Interpretation of the Antitrust Statute. The Antitrust Statute is a codification of antitrust principles prevailing in most market-oriented economies. The Antitrust Statute was modeled mainly after the U.S. and European Community antitrust legislation, but Chilean legislation was also considered.

Contrary to the common law system, under the Mexican legal system, which is "civil code" based, statute interpretation is very limited and some times virtually non-existent. Mexican Law purports to be comprehensive and unambiguous, leaving the courts with very limited freedom to interpret the law. Accordingly, court resolutions have very little impact in the formation and development of a body of law in Mexico.

D. Application. The Antitrust Statute applies to all "Economic Agents", which are defined to include all individual or legal persons, government entities, associations, professional groups, trusts or any other form of participation in the economy.

The Antitrust Statute is particularly concerned with the "effects" that the acts and practices regulated by it may have in a free-competition economy. Therefore, the Antitrust Statute applies to all transactions having an effect on competition in the Mexican economy regardless of the location where the transaction occurred or the nationality of the parties involved therein.

a. Strategic Areas. The Antitrust Statute does not, however, apply to activities performed by the Government in strategic areas referred to in Article 28 of the Mexican Constitution and the FIL. Such activities are basically petrochemicals, the minting of monies, mail, telegraph, railroads, electricity, etc., but only to the extent the corresponding state agency is performing that specific function.

b. Worker Associations. The Antitrust Statute also does not apply to legally established workers’ associations (labor unions) formed to protect their own interests.

c. Author, Artist, and Inventor Privileges. The Antitrust Statute does not apply to rights granted to authors, artists and inventors for the production of their works for a specific period of time.
d. Cooperative Production Companies and Associations. Cooperative production companies and associations also do not constitute monopolies, as long as the following conditions are met: (i) the product is a principal source of wealth in the region in which it is produced; (ii) the selling and distribution of the product is outside of Mexico; (iii) the membership is voluntary; (iv) they do not issue government type permits; and (v) they are legally incorporated.

E. Prohibited Practices. The Statute states three basic practices that are prohibited: (i) absolute monopolistic practices; (ii) relative monopolistic practices; and (iii) concentrations.

a. Absolute Monopolistic Practices. Such practices are among competing agents and in a horizontal economic activity. Those practices are any contracts, agreements, understandings or combinations among competing agents that have the purpose or effect of either: (i) price fixing; (ii) artificially controlling the production, distribution, processing or commercializing of products; (iii) divide the markets; or (iv) manipulate bidding.

These practices are considered per-se monopolistic and illegal and the acts resulting from those are considered null and void.

b. Relative Monopolistic Practices. Such practices are among non-competing agents, in a vertical economic activity.

Those practices that have the purpose or effect of: (i) unlawfully displacing economic agents; (ii) substantially impeding the presence of other economic agents in a market; or (iii) establishing exclusive advantages for certain agents in such markets, are considered relative monopolistic practices.

These practices are not considered per-se monopolistic or illegal, but are subject to a rule of reason test. In considering whether a party has engaged in a relative monopolistic practice, it must be determined if the party: (i) has substantial power with regard to goods or services in the relevant market; and (ii) falls within the cases provided by the Statute. The sanctionable practices provided for by the Statute include discriminatory distribution and dealings, restriction of products or services from certain customers, tie-in/conditional sales, and collusion among economic agents to pressure a client or provider with the purpose of preventing certain conduct, or of threatening retaliation for certain actions.

i. Substantial Power. In determining whether a party has substantial power, certain factors will be considered, including: (i) if it can unilaterally fix prices or restrict supply in a relevant market; (ii) the possibility of access to the market; (iii) the existence of barriers to the market; (iv) the power of competitors; and (v) the party’s recent behavior.

The Antitrust Statute does not consider "predatory pricing" to be a specific violation because the drafters considered the term to be too difficult to distinguish from vigorous competition. However, it could be attacked as an unspecified violation, under the general provision included in paragraph VII of Article 10 of the Antitrust Statute.

ii. Relevant Market. For a determination of a relevant market, certain factors are considered including: the possibility of substituting goods and services, the costs of bringing goods from another market, the possibility of consumers going to other markets, and restrictions for accessing other markets.

c. Concentrations. Concentrations are considered to be the merger, acquisition of control, or any act by which companies, associations, stocks, shares, trusts or assets in general are consolidated (concentrated) among or between economic agents in order to diminish, harm, or impede free competition among similar goods or services in a market.
i. **Criteria.** The Statute states various criteria for the determination of whether such concentrations should be challenged, including the identification of the relevant market, the Economic Agents that supply such market, their relative power, and the magnitude of the concentration. Concentrations not subject to pre-merger notification cannot be challenged if a year has elapsed after its consummation.

ii. **Previous Notice.** Previous notice must be given to the Federal Commission of Competition before carrying out planned concentrations in the following three situations: (i) a transaction valued at 12 million times the minimum daily salary in general effect in the Federal District of Mexico, approximately US$53,800,000.00; (ii) a transaction involving 34% or more of the assets of an Economic Agent whose sales or assets amount to more than US$53,800,000.00 (12 million times the minimum daily salary); or (iii) if two or more Economic Agents are involved in a transaction and their annual volume of sales, together or separately, amounts to more than US$215,200,000.00 (48 million times the minimum daily salary). If any of these thresholds is satisfied, the transaction must be reported to the Commission.

iii. **Commission's Determination.** The Commission must be notified in writing with accurate information of the planned concentration, after which the Commission must issue a resolution within 45 calendar days after receipt of the notification or after receipt of additional information requested by the Commission after said notification. Such resolution will be final. Failure to respond in time is deemed approval.

**F. The Federal Competition Commission.** The Federal Competition Commission, which is an independent administrative agency that enforces the Antitrust Statute’s provisions, is composed of five Commissioners of Mexican citizenship appointed by the President of Mexico, and it has powers to investigate violations of the Statute and to sanction violators.

a. **Procedure.** A proceeding can be initiated by an interested party or by the Government. In the case of absolute monopolistic practices, any person can file a complaint. In the case of relative monopolistic practices, as well as in the case of forbidden concentrations, only persons allegedly adversely affected can bring a complaint. Thereafter, the Commission can require reports, documentation, and can summon or depose all those related to the case. The Commission will have a period of 60 calendar days once the record is complete to issue a determination. The Commission has the right to dismiss complaints that in its opinion are clearly without merit.

b. **Sanctions.** The Commission may order the suspension or suppression of such practices, or may order the partial or total break up of such concentrations. The Commission may also issue fines that range from US$33,625.00 to US$1,681,250.00 (7,500 to 375,000 times the daily minimum salary in effect in the Federal District of Mexico). The Commission may double such fines when sanctioning recidivism.

Under the Antitrust Statute, private parties also have the right to bring a judicial action for damages. During the proceedings the affected party must demonstrate that they suffered harm and prejudice due to the monopolistic practice or the concentration being challenged.

c. **Reconsideration.** The affected party may request reconsideration for a period of up to 30 calendar days after the resolution has been issued. The Commission will then issue its resolution with respect to the reconsideration within 60 days. Silence will signify that the Commission has confirmed its holding.

Affected parties retain their additional writ of "amparo" to appeal decisions of the Commission. "Amparo" is the Constitutional action to determine whether the act of the authority violated the constitutional rights of the appellant in the particular case.
11. Imports. The current Mexican Authorities’ position on imports authorization is liberal and open.

A. Import Permits and Duties. Import permits are practically eliminated with a few exceptions (i.e. raw material, foods, guns, etc.). Import duties could exceptionally go up to 100% (or more, eventually) ad valorem, but the average is still 10% ad valorem. Import duties on permanent imports are based on the commercial value of the products or merchandise, and are:

a. A General Tax applied in accordance with the rates established in the General Tariffs of Imports; and

b. Compensatory quotas on products or merchandise imported under international unfair trade practices (i.e. dumping).

The importation of goods is taxed under the value added tax, and the importer is liable for such tax. The basis to calculate the value added tax will be the one resulting from adding the value of the products or merchandise used to calculate the general importation tax, plus the amount of this tax together with any other tax or fee that had to be paid for the importation. The tax rate of the value added tax is 15%.

Additionally, the importation of wines, beers, alcoholic beverages and tobacco, cigarettes and cigars are levied with a STPS. For the determination of the STPS, the same basis used for the VAT must be used.

B. Temporary Imports. Temporary imports are basically limited to those that do not exceed the terms specifically determined by the Customs Law (Art. 106) (i.e. 1 month for trailers which carry imports or exports, 6 months for containers or packages of exports, or for merchandise for trade shows, etc. or by the Ministry of Economy in general application rulings applicable to "Maquiladoras" or by the general rulings applicable to companies under the Export Incentives Programs referred below, for their equipment, machinery, raw materials and other assets destined for industrial production processes. There are no import duties, STPS or VAT to pay for these type of imports.

12. Exports. To carry out exports, a permit from the Ministry of Economy is also required. However, such permit is not required for certain products or merchandise if they are exempted in the resolutions that the Ministry of Economy issues from time to time.

Exports should also be carried out in accordance with the Customs Law, its Regulations and the General Rules Regarding Customs.

A. Export Permits and Duties. Under the Customs Law an exporter must pay the General Tax, applied in accordance with the rates established in the General Tariff of Exports.

As with imports, the general tax is based on the commercial value of the product or merchandise excluding insurance and freight costs. This commercial value must be shown on the invoice. If in the Customs Authorities’ judgment the commercial price is higher, they will assess such value.

Definitive exports of goods and services are taxed under the Value Added Tax at a 0% rate.

13. Export Incentives. The current trend towards incentives is to continue the gradual phasing-out of direct tax incentives, which are practically non-existent for activities other than those that are export-oriented. One of the priority objectives has been to promote exports, especially non-oil exports. The Mexican Government created incentive programs to stimulate the export of manufactured goods. Companies may apply and enjoy these Programs indefinitely as long as they comply with their requirements. These export incentives apply to all Mexican incorporated entities, regardless of size and level of foreign participation. A general summary of such Programs is discussed below:
A. Temporary Imports to Produce Export Articles Program ("PITEX"). The Ministry of Economy runs the program of temporary imports to be integrated into exported processed goods.

Under this program qualifying local entities may request authorization from the Ministry of Economy to enroll in the PITEX program. In order to qualify, the following thresholds must be met (a certain amount of exportation to be allowed to temporarily import the items listed):

a. exportation of US$500,000.00 or 10% of gross annual sales, in order to temporarily import: raw material, parts, components, packaging materials, fuels, and lubricants used in the production of exporting merchandise; and trailer containers and boxes; or

b. exportation of 30% of total sales, in order to temporarily import: tools, equipment and devices for investigation and security; products necessary for hygiene, sterilization and contamination prevention; work manuals, industrial blueprints, telecommunications and computing equipment; and, production machinery, instruments, and spare parts; equipment for the laboratory, quality control, employee training and the administrative development of the entity.

Once the local entities are approved for enrollment in the PITEX Program, they may obtain the following benefits:

a. Up to one month of (duty free) import: towing and semi-towing trailers.

b. Up to six months of (duty free) import: packing materials, vehicles for diplomatic missions and samples.

c. Up to one year of (duty free) import: materials for international conventions, materials and equipment for film industry, test vehicles.

d. Up to 10 years of (duty free) import: Containers, airplanes and helicopters; passenger, cargo and fishing ships and railcars.

The corresponding resolution issued by the Ministry of Economy will define the scope and term of effects of the Program, the assets to be imported and exported, customs treatment to shrinkage, and other compromises.

The Ministry of Economy may authorize the local sale in the Mexican market of part of the production having foreign content, covered under the PITEX program, for up to 30% of originally export-bound production as long as the company has a positive balance of trade and there is payment of the suspended import duties on the foreign contents thereof.

Additionally, the PITEX Program allows for the possibility of re-exporting through a different port from the one used for the imports. It also permits the definitive import of the equipment mentioned in item (b) above, allowing also to sell it or transfer it through a bailment agreement to a third party, provided that the merchandise remains in the plant of the importing company and is used in the production of export products in compliance with this Program.

On the last working day of each May, a PITEX Company has to present a filing before the Ministry of Economy. If the PITEX Company does not comply with this filing, it cannot apply the benefits of the PITEX. If the PITEX Company has not presented this filing by the last working day in June, the Ministry of Economy may cancel its registration.

The PITEX Company whose registration has been cancelled by the Ministry of Economy, cannot apply for another export incentive program during a period of five years, if the cancellation is due to either of the following:
i. not being located either at the fiscal domicile or the registered site for the program; or

ii. inability to establish custody or existence of merchandise; or not having the merchandise in the registered domicile, or being under a fiscal executive proceeding.

B. Export Trade Companies Program. ("ECEX") Two types of ECEX exporting companies are currently regulated. The purpose of these types of companies is to support exporting activities by local producers. ECEX companies are eligible for a variety of non-tax incentives in the form of financial and promotional assistance, including preferential financial support by the Exporting Government Financial Entities.

a. Exports Consolidation Companies. This type of company will support producers and gather and acquire products to be subsequently exported. Legal entities need a minimum capital of $2,000,000.00 pesos (approximately US$ 172,900.00 at a rate of $11.57 Pesos per Dollar), to export goods or merchandise of 5 different national producers, and to maintain a minimum amount of US$3,000,000.00 of their direct exports, per year, starting with the first year of operations since registration.

b. Exports Promoting Companies. This type of company will gather and acquire products to be subsequently exported. Legal entities need a minimum capital of $200,000.00 pesos (approximately US$17,290.00 at a rate of $11.57 Pesos per Dollar), to export goods or merchandise of 3 different national producers, and to maintain a minimum amount of US$250,000.00 of their direct exports, per year, starting with the first year of operations since registration.

C. High Exporting Companies Program. ("ALTEX") ALTEX governs incorporated legal entities (1) directly exporting annually at least US$2,000,000.00, or at least 40% of its gross annual sales; or (2) indirectly exporting through third parties (final exporters) products or merchandise equivalent to at least 50% of its annual sales.

The ALTEX program benefits include: the PITEX program benefits, the ECEX benefits, and value added tax refund as indicated above.

Also, ALTEX entities are provided greater financial assistance, top priority in customs clearances, dispensation of the requirement to retain the services of a customs broker, and special promotional assistance in Mexico and overseas.

ECEX, PITEX and Maquiladora (see below) companies can request a 0% rate value added tax payment on local purchases of materials and supplies integrated into the production to be exported. Accordingly, local suppliers charge a 0% value added tax rate on sales to ECEX, PITEX and ALTEX companies, as though they were exporting such supplies themselves.

D. Drawback for Import Duties by Importers. ("DRAWBACK") Under DRAWBACK, all direct exporters or indirect exporters (suppliers of exporters) are entitled to a refund of import duties paid the prior year on imported raw materials, parts, containers, packages, fuel, and lubricants integrated into finally exported goods or sold to other entities who actually performed the export.

E. Maquiladoras (In-bond Companies).

a. Maquila Regulation. On June 1, 1998 the "Decree for the Fostering and Operation of the Exporting Maquiladora Industry" ("Decree") (amended on November 13, 1998, October 30, 2000, December 31, 2000, May 12, 2003, and October 13, 2003) was published, adjusting certain provisions to the compromises under NAFTA. Since the first Maquila Decree of August 15, 1983, these kinds of operations have been following similar basic rules.

b. Approval and Registration as Maquiladora. A Maquiladora company must obtain the approval of, and register as a Maquiladora, before the Ministry of Economy. Maquiladoras can have up to 100% foreign-owned
equity without the previous approval of the Foreign Investment Authorities, but must be registered at the National Registry of Foreign Investments.

The Decree provides that the Ministry of Economy will request the Ministry of Treasury’s advice to grant such approval, provided that the *Maquiladora* applicants:

(i) Are in good standing in their tax obligations;

(ii) Are not under a fiscal executive proceeding;

(iii) Are currently registered on the Importers Registry;

(iv) Do not have partners or shareholders who are defendants in a criminal proceeding, have been prosecuted due to tax or criminal law violations, or have been legal representatives, partners or shareholders of an entity whose Maquila standing has been cancelled in the last five years (such cancellation due to enumerated violations; see Maquila Decree, Article 6, II(b)).

(v) Annually export at least US$500,000.00 or 10% of its gross annual sales when it temporarily imports raw material, parts, components, auxiliary materials, package material, fuel and lubricants used for manufacturing products to be exported, as well as trailer containers and boxes; and

(vi) Annually export at least 30% of its gross annual sales when it temporarily imports tools, research equipment, industrial safety accessories, products necessary for hygiene, sterilization and contamination prevention, telecommunications and computers; machinery for the production process; equipment for lab, measurement and test, quality control, personnel training and administrative development of a New Plant.

According to the Decree, the effects of an approved *Maquiladora* program will be indefinite without the need of periodic updating. However, *Maquiladoras* must report annually to the Ministry of Economy, at the latest by the last working day of May, all of the foreign trade operations they performed during the prior year.

The Ministry of Economy application basically requires a proposal of what is to be produced, the amount of capital/equity to be invested, the number of jobs to be created, the site of the *Maquiladora*, the percentage of Mexican content to be brought in, the overall net positive foreign currency generation, and the corresponding *Maquila* (services) agreement certified by a notary public.

c. **Geographical Restrictions.** There are no geographical restrictions as to the location of facilities destined for industrial development, although there are local rules and regulations on zoning and environmental matters which make it difficult to locate *Maquiladoras* in large urban centers such as Mexico City, Guadalajara and Monterrey.

d. **Imports of Production Assets and Raw Materials.** Following approval by the Ministry of Economy, the manufacturer may operate its *Maquiladora* assembly facility, and import in-bond the fixed assets, components and raw materials necessary to operate, as long as such fixed assets, components, and raw materials are finally taken outside of Mexico.

The components and materials expected to be processed and exported, their corresponding containers, packaging materials, labels and brochures may remain in Mexico for eighteen (18) months maximum, their transportation trailer boxes and containers for two (2) years maximum. Machinery, tools, fixtures, spare parts, equipment and instruments as well as computer and telecommunication equipment (fixed assets) to be used, may remain in Mexico as long as the Program is in force.
The Ministry of Economy approves any machinery or tools transfer between Maquiladora companies and/or their furnishers, provided that the General Import Tax for such machinery has been paid.

e. **Taxes on a Maquiladora.** * As of 2003, there are three methods to determine taxes on Maquila.

i. In-bond processing value plus profit on assets. This tax base is determined from transfer price studies by adding 1% of the book net value of the material and equipment of the Maquiladoras.

ii. **Safe Harbor.** The higher amount is applied:

(a) 6.9% of the total value of assets used in the Maquiladoras, or

(b) 6.5% of the total amount of the in-bond processing costs and operating expenses incurred by the Maquiladora.

iii. Margins of Transactional Operating Profits plus Profits on Assets and Adjustments for Financing. These taxes are determined by a transfer price study considering the profitability of the Maquiladora.

*Before current taxing methods for "Maquiladoras" were in place, there was concern in the industry that they would be considered Permanent Establishments, and that double taxation would occur. Since 1999, as long as they: (i) comply with the rules for "Safe Harbor", "Value Plus Profit on Assets" or "Profit Margins plus Profits on Assets," and (ii) the Country of the resident from abroad ("Maquiladora's Client") has signed a Tax Treaty with Mexico, this issue is no longer a concern.

f. **Sub-maquila Operations.** Maquiladora companies can hire local companies to perform specific manufacturing operations. These sub-maquila operations must also be authorized by the Ministry of Economy for an indefinite time period.

g. **Rules on Residues.** Hazardous residues generated in "Maquiladora" production, transformation, manufacture, or repair processes, must be re-exported or returned to the country of origin for disposal during the period determined by the Ministry of the Environment and Natural Resources ("SEMARNAT") through the National Ecology Institute.

Non-hazardous residues may be returned to the country of origin or destroyed in government-approved facilities. Maquiladora companies may legally dispose of their non-hazardous residues in Mexico by donating them to charities, which can resell them, or sell them to a Mexican company for recycling or transfer them over to other Maquiladoras. These residues include: i) containers and packaging material of the temporal imported material, and under the Decree, ii) manufactured material rejected for non-complying with the company’s quality control.

h. **Annual Filing.** On the last working day of May, a Maquiladora company has to present an annual filing before the Ministry of Economy. If the Maquiladora company does not comply with this filing, it cannot apply the benefits of the Maquiladora Program. If the Maquiladora company has not yet presented this filing by the last working day of June, the Ministry of Economy may cancel its registration.

i. **Cancellation.** There is cause for cancellation if the Maquiladora company does not:

i. comply with the obligations provided for in the Decree;

ii. comply with any obligation indicated in the corresponding authorization to operate as a Maquiladora company;
iii. not being located either at the fiscal domicile or the registered site for the maquila operation; or

iv. inability to establish custody or existence of merchandise; or not having the merchandise in the registered domicile, or being under a fiscal executive proceeding.

Additionally, if the Ministry of Economy orders a cancellation due to either of the last two situations, the *Maquiladora* company may not apply for any other export incentive program during a period of five years.

**F. Strategic Tax Warehouses.** As of 2003, a new kind of tax warehouse called "Strategic" was implemented. A special authorization by the Ministry of Treasury is required. Basically, this category of warehouse has the following advantages:

a. Products within them shall not pay foreign trade duties;

b. Products within them need not comply with the Mexican Mandatory Standards (NOMs); and

c. *Maquila*, equipment and devices may be in the Warehouse as a temporary base for two years without paying taxes.

**14. Environmental Legislation.** The principal piece of environmental legislation in Mexico, is the General Law of Ecological Equilibrium and Environmental Protection ("Environmental Law").

The overall objective of the Environmental Law was to insert into legislation the goals of the environmental movement which is focused on the principal of the advancement of a sustainable environment. The particular objectives are to:

i. initiate a process of decentralization of environmental matters to the local levels;

ii. reduce the discretionary authority of the environmental authority;

iii. increase the opportunities for the people’s participation in environmental affairs;

iv. strengthen and enrich the instruments of environmental politics; and

v. remove the regulatory obstacles to the economic activities that do not represent an environmental harm.

**A. Environmental Impact Evaluation (EIA).** Before initiating operations, authorization will be required for any person engaging in the execution of public or private activities that may cause ecological imbalances or exceed the limits established in the law or in the NOMs. The Federal Government has given importance to certain public and private activities, as the ones most likely to cause ecological imbalance. The Government has regulated the environmental impact of such public and private activities and made them subject to prior evaluation by the SEMARNAT.

The powers of the Federal Government have been limited with regard to the control of atmospheric pollution and the evaluation of its environmental impact. Soon, control will be decentralized in great part in favor of the local authorities. Four areas of the law were created: the general ecological law of the territory; the regions; the localities and the seas. The local law is understood to be an instrument to induce and regulate the use of the land in the rural areas in a manner congruent and complementary with the regime of the human settlements. With the goal of the congruence of the planning of the human settlements with the preservation of the environment, the project defines nine (9) environmental criterion for urban planning ranging from those that allow the establishment of intermediate zones specifically for activities that are highly dangerous, and those that forbid the construction of houses or other structures that could put the human population in danger.
The EIA, a document based on technical studies, will outline the significant and potential environmental impact that may be caused by a project or an activity. It must be filed with the SEMARNAT, and/or with state or municipal authorities and approved prior to the commencement of operations. This statement should also include the manner in which to avoid or diminish the impact of such negative occurrences.

There are three levels of EIAs: general, intermediate or specific. Depending on the characteristics of the activity, its magnitude, the environmental impact and/or the site to be utilized, the information that is provided by the undertaker may be required to be more precise. Previously, SEMARNAT required the registration of all third parties conducting the environmental studies. The Environmental Law eliminates the obligatory registry of service providers of environmental impact material. During the EIA proceeding the applicant will be able to obtain all the permits, licenses or federal environmental authorizations that are required.

SEMARNAT is the only competent authority to evaluate the environmental impact caused by the following activities: those related to federal public constructions; hydraulic systems; general ways of communications; pipelines and carbo-lines; chemical, petrochemical, siderurgy, paper, sugar, beverages, cement, automotive and electric power generation and transmission industries; exploration, extraction, and treatment of mineral and non-mineral substances; installation, treatment and disposal of toxic waste; tourism developments in federal areas; radioactive water treatment or disposal facilities; exploitation of forests; hazardous activities; and any activity that may cause ecological imbalance in two or more states, countries or international jurisdiction zones.

The Law defines with great precision the works and activities that could put the preservation of one or more species in danger, or cause harm to the ecosystem. These activities include: forest plantations, changes in the use of the earth in forested areas, such as in the jungles or in dry zones, industrial parks where very dangerous activities take place, development of housing on the coasts, works and activities in swamps, lakes, rivers, marshes connected to the ocean as shoreline or federal zones, fishing activities, aquaculture or fish farming.

B. Prevention and control of air and water pollution, hazardous wastes and other pollutants.

a. Air Pollution. All facilities releasing pollutants into the atmosphere must comply with several requirements, such as maintaining systems and equipment to control atmospheric emissions, keeping an inventory of emissions and installing measuring equipment.

b. Water Pollution. Release of residual water or discharges into any body of water is subject to authorization of the National Water Commission. If discharges are made into the sewer system, authorization must be obtained from the municipal authorities, unless toxic wastes are discharged, in which case, SEMARNAT would be the competent authority to contact. Consequently, the discharge, deposit or infiltration of polluting solid waste (i.e. pesticides, fertilizers, residues or any material waste) into the soil shall be subject to the Federal provisions.

c. Hazardous Waste. Hazardous wastes and toxic materials generated from a transformation or production process, must be disposed of pursuant to applicable regulation and standards. Companies that may generate, or in which the handling of toxic wastes is involved, must obtain prior authorization and comply with the following:

i. Register in the Registry of toxic waste producing companies;

ii. Keep a monthly record of all toxic wastes generated;

iii. Handle and dispose of the toxic wastes in accordance with the corresponding standards; and

iv. Prepare a semi-annual report containing all the movements of toxic wastes.
d. Other Pollutants. The emission of noise, vibrations, thermal and luminous energy, odors and visual pollution is subject to compliance with the corresponding standards. The Ministry of Health may conduct visits and inspections to determine whether any of these emissions are hazardous to human health.

e. Compliance Incentives. Compliance with such programs is extremely expensive. The Federal Government is of the opinion that these programs are necessary to encourage and maintain a healthy environment. The Government, however, is willing to provide incentives for those in compliance with these programs. For example, with regard to laws regulating the discharge of residual water, the regulations state that businesses which treat their water to meet the quality standard for the stream or lake receiving the discharge will have that amount of water subtracted from their water consumption fee.

C. Penalties.

a. The Environmental Law is aimed toward strengthening the criminal sanctions associated with crimes committed in violation of the environmental laws. The law includes a marked increase in the penalties. Certain crimes are originally penalized with six years of prison. For other crimes the penalty is 20,000 days of minimum wage daily salary (around US$92,000.00 dollars). For example, violators of the Federal Water Rights Law could face fines of 20,000 minimum salary days (US$92,000.00) and jail terms of 6 months to 6 years under the environmental laws now in effect. The authorities also have the ability to grant the perpetrators the option of covering the fine by installing the necessary equipment, in lieu of payment and/or prison time, to prevent further contamination of the environment.

b. In assessing sanctions the following criteria shall be taken into consideration:

i. Gravity of the sanction in relation to the impact it had on the public and the environment;

ii. Economic conditions of the perpetrator;

iii. Previous sanctions that have been levied against the perpetrator;

iv. Intentional or negligent nature of the action or the omission constituting the infraction;

v. Direct benefit obtained by the perpetrator by the acts which motivated the sanction.

c. In general, the sanctions associated with the environmental laws are aimed at making pollution and contamination of the environment prohibitively more expensive than installing the appropriate equipment and following the proper procedures for the treatment and disposal of substances considered harmful to the population and the environment. The fines collected for violation of the environmental laws are destined to be used reinforce the inspection programs associated with such laws.

V. DOING BUSINESS IN MEXICO (SPECIAL AREAS).

1. Financial Services. Under NAFTA and the Credit Institutions Law (the "Institutions Law"), financial institutions of Canada and the U.S. are allowed to establish Mexican subsidiaries with the right to perform the same activities they perform in their own countries or simply establish representative offices ("Representative Offices") within Mexico. Provisions regarding establishment of Mexican subsidiaries are explained below.

A. Representative Offices. Representative Offices of foreign financial institutions are regulated by the "Rules Applicable to the Establishment and Operation of Representative Offices of Foreign Financial Entities," issued by the Ministry of Treasury and Public Credit ("SHCP"), and by Article 7 of the Credit Institutions Law.
Generally, Representative Offices may provide and gather information; negotiate, monitor and follow up on loans or other transactions; initiate proceedings to collect credits granted and, in general, perform activities entrusted to them by the head office. Representative Offices may not lend or receive monies nor participate in financial intermediary activities for their head office.

Representative Offices must comply with the following requirements, among others: (i) Foreign financial institutions must obtain the prior authorization from the SHCP and the National Banking Commission (the "Banking Commission") in order to establish and operate a representative office. This authorization is non-transferable; (ii) The Representative Office’s name, designation of its representative, any change of location, or its closing must be previously approved by the SHCP; (iii) The Representative Offices must advise the SHCP (within 15 days of commencement of operations) of their address, phone numbers and the identity of their personnel; (iv) All advertising must be previously approved by the Banking Commission; and (v) The Representative Office must submit periodic information to the SHCP and the Banking Commission about its activities and financial condition, as well as be the subject of Banking Commission inspections and be forthcoming with any documentation requested.

If a Representative Office fails to comply with said Rules, the Banking Commission may impose administrative sanctions. Furthermore, the SHCP may revoke an office’s authorization to operate if the Foreign Financial Entity no longer operates within the defined standards in its home territory; becomes the subject of insolvency or bankruptcy proceedings; in any way misrepresented itself on the application for authorization; or if, having been previously sanctioned, continues to violate the Law or Rules. Additionally, revocation of authorization may occur if the Representative Office does not start functioning within six months of having received authorization to do so; suspends activities for more than one year; or undertakes activities different from those authorized.

B. Exclusions. NAFTA also provides for exclusions which permit each NAFTA country to exercise important regulatory and governmental powers and economic policy unfettered by NAFTA. Among exclusions that a NAFTA country may adopt are those to counteract serious balance of payments difficulties or the threat of such difficulties. The measures must: (i) conform to International Monetary Fund rules; (ii) be necessary for the protection of national security; and (iii) be to conduct or provide retirement and statutory social security plans, or any activity or service for the account of, with the guarantee of, or using the financial resources of a government entity.

2. Financial Services in Mexico. Due to NAFTA, Mexico has afforded access to foreign financial service providers through new legislation, regulations, interpretations and other measures implemented and enforced by the SHCP and its affiliated regulatory commissions ("Banxico"), the ("CNBV") and the ("CNSyF").

A. Establishment of Financial Institution Subsidiaries in Mexico. Foreign financial service providers and investors already engaged in financial service activities in their countries may apply to establish or acquire Mexican-chartered financial institutions to conduct similar activities in Mexico. Authorization must be granted from SHCP and opinions given from Banco de Mexico and the National Banking and Securities Commission.

Once an eligible investor establishes or acquires a bank or securities firm in Mexico, it may form a “financial group holding company” and thereby expand into other types of financial services on the same terms as domestic Mexican investors according to the terms of the international treaties or accords governing such activities. To invest in the capital stock of an affiliate, the foreign financial institution must conduct the same type of activity in the country where it is incorporated, directly or indirectly, as the affiliate intends to conduct in Mexico. A financial group may be formed by establishing or acquiring additional Mexican companies engaged in the full range of financial services activities, including banking, securities, insurance, factoring, leasing, bonding, and warehousing.

Financial service companies affiliated through a financial group may share a common name, and market their products through the offices of any other company in the group.
a. Special Restrictions and Powers. Under NAFTA, an investor seeking to establish or acquire any given type of financial service provider (i.e., bank or securities firm) must already be providing the same general type of financial service in the territory of its home NAFTA country, in addition to the general requirement that an investor meets the rule of origin. In order to reserve the real enjoyment of NAFTA’s benefits only to entities of the three countries, NAFTA’s article 1113 states each NAFTA country is entitled to deny the benefits of NAFTA if it is an enterprise owned or controlled by a country that is not a party to the agreement and the enterprise has no substantial business activities in the territory of the country where it is constituted or organized.

Each investor, and its affiliates, will own or control only one financial institution of each type in Mexico.

Except for insurance companies, Mexico may require that a financial institution that is to be established or acquired in Mexico by an investor from another NAFTA country, be "wholly owned" by that investor.

Consistent with existing Mexican law, Mexico may deny access to its financial services market to foreign banks or securities firms already affiliated with commercial or industrial companies having operations in Mexico (not with operations abroad). However, on a case-by-case basis, Mexican authorities may consider exempting from this restriction if the affiliation with a commercial or industrial corporation operating in Mexico is determined to be "harmless," and the commercial corporation derives at least 90% of its worldwide income from financial-related activities.

b. Capital and Asset Limits. The capital/asset limits for each type of financial service subsidiary are summarized below:

i. Banks. As of January 1, 2000, a U.S. or Canadian investor is permitted to acquire an existing Mexican bank only if the capital of the acquired bank, together with the capital of any Mexican bank already controlled by the acquirer, would not exceed 4% of the aggregate capital of all banks in Mexico.

Moreover, if at any time the aggregate capital of all commercial banks established in Mexico by investors from other NAFTA countries reaches 25% of the aggregate capital of all commercial banks in Mexico, Mexico may request consultations with the U.S. and Canada to discuss a remedial action, such as further temporary limitations on market participation. If they do not agree during such consultations, any NAFTA country may seek arbitration under the appropriate NAFTA provisions.

ii. Securities. Foreign acquisition of an existing securities firm or a securities specialist is regulated as follows: in practice, SHCP and CNBV authorize in writing (and sometimes tolerate) higher percentages than the ones allowed by NAFTA (30% limit); the current SHCP/CNBV limit is 49%.

However, in order to establish a subsidiary ("filial") in Mexico, a minimum of 51% of the capital stock of the subsidiary must be owned by the foreign financial institution. Per NAFTA provisions, the aggregate limit of the foreign financial affiliates is 30% of the aggregate capital of all securities firms in Mexico.

iii. Insurance. Subject to an authorization from the SHCP, NAFTA investors may acquire majority interest in a Mexican Insurance company. The limit does not apply for companies providing complementary activities to insurance companies such as brokers, claim adjusters and actuarial firms. Limits apply separately to life and health insurance and to casualty and other types of insurance.

As an exception, U.S. or Canadian insurance companies entering into joint ventures with Mexican insurance companies were permitted to expand their equity participation. Such investments increased from 30% of common stock in 1994, to 100% by January 1, 2000. No aggregate or single-institution capital limits apply to these investments.
iv. **Other Financial Services.** Mexican factoring and leasing companies of other NAFTA country investors are not subject to capital limits, provided they obtain an authorization from SHCP. Warehousing, bonding, currency exchange and mutual fund management firms are not subject to any capital limits.

Following NAFTA, Mexico has been allowing investors to form "limited-scope financial institutions," which can engage in lending and certain other bank-like activities, but not deposit-taking. Mexico agreed to permit non-bank investors from the U.S. and Canada to establish limited-scope financial institutions in Mexico, to provide consumer, commercial, or mortgage lending or credit card services.

v. **Social Banking.** The Social Banking Law was published in the Official Federal Gazette on June 4, 2001. The intention of this Law is to regulate this type of banking and consequently promote the financing of micro-entrepreneurs.

It provides for the creation of two kinds of Entities: (i) Social Financial Entities ("Financial Entities"), and (ii) Social Cooperatives for Savings and Loans ("Cooperatives").

(a) **Financial Entity.**

A Financial Entity is a regular Capital Stock Company with a minimum fixed stock without withdrawal right. In addition it could have a "Variable Capital" which can increase or decrease through stockholder meeting resolutions and by performing the appropriate filings.

The shares representing a Financial Entity may be acquired by any individual or entity, except: (i) any financial institution; (ii) holding companies; (iii) banks; (iv) non-bank banks (in Spanish known for its acronym "Sofoles"); (v) credit information companies; (vi) stock exchange companies; (vii) stock brokers; (viii) stock investment; (ix) tax warehouses; (x) credit unions; (xi) financial lessees; (xii) factoring companies; (xiii) savings and loans companies; (xiv) money exchange companies; (xv) insurance companies; (xvi) "patronato del ahorro nacional"; (xvii) insurance solidarity groups; (xviii) bond companies; and (xix) retirement funds managing companies (a.k.a. "Afores").

No individual or company may acquire shares of the Capital Stock of the Financial Entity higher than 3% and 10%, respectively. In order for a company to acquire or transfer up to 10% of a Financial Entity, it is necessary to acquire prior Commission authorization. The Commission shall grant such authorization prior to a favorable opinion from a Federation (affiliation of 10 Entities).

In order to incorporate a Financial Entity, the following steps must be followed:

Present a Request before the Federation to which it will become an affiliate. The Federation will issue an Opinion approving (or not) the incorporation of that entity within 90 calendar days;

Once the Request is filed before the Commission, it shall grant or deny the corresponding Authorization to incorporate a Financial Entity within a term of 120 calendar days; and

The Authorization shall be published in the Official Federal Gazette and in 2 major newspapers of the domicile of the Entity.
(b) **Cooperatives.**

Regarding the Cooperatives, they are entities formed by a group of partners (up to 200 partners) to save and loan monies among themselves. The Law provides that Cooperatives may incorporate a Founder Institution which shall provide financial support and participate in its corporate bodies.

(c) **Federations and Confederations.**

A Financial Entity may affiliate to a Federation within the following 10 working days after having its Authorization from the Commission. The affiliation to a Federation is not mandatory. However, a non-affiliated Financial Entity has to be supervised by a Federation.

Federations are affiliated to Confederations (5 Federations). The Confederations manage the protection fund, which is a saver’s protection system created to protect the Clients’ deposits.

The Protection Fund will pay the savers’ deposits until the amounts of 4,000; 6,000; 8,000 and 10,000 Units of Inversion (UDI by its initials in Spanish) are reached, depending on the Operations Level of the Entity. The current value of each UDI is approximately MexCy $3.23 and increases every day according to inflation. Also, the Protection Fund will finance the Financial Entity in case of merging, sale or split-up thereof.

The Protection Fund is constituted with monthly contributions from the Financial Entities, which amount depends upon the Operations Level of each one. If a Financial Entity does not make its contribution on time, then it has to pay late payment interests thereon.

The Federal Government may give a contribution to the Protection Fund only once.

**B. Local Regulations.** Consistent with NAFTA, on April 21, 1994 the SHCP issued the Regulations for the Establishment of Subsidiaries of Foreign Financial Institutions. These Regulations state requirements and procedures necessary for the establishment of subsidiaries of foreign financial institutions as well as the purchase of majority interests in such institutions. The major provisions of such Regulations are:

- **a. Petition.** If a foreign financial institution wants: (i) to establish a subsidiary; or (ii) to acquire the majority of the capital stock representative of a financial entity in Mexico, such party must present a petition to the Financial Liberalization Committee of the SHCP. The Committee was created to: (i) assist in the preparation of specific regulations to accomplish the NAFTA’s requirements; and (ii) to monitor the establishment of foreign financial entities in Mexico and the representative offices of foreign financial entities.

  Such petition must contain, among other things, the following information: the name, domicile and amount of capital stock and assets of the foreign institution, the type of subsidiary to be established, or the local financial entity in which it wants to purchase a majority of capital stock, a business plan, and other information particular to that foreign institution. Such petition must also be accompanied by various corporate and financial documents, as well as a draft of the proposed subsidiary's by-laws, and documents supporting the solvency and legality of the institution. The Committee may request additional information from the one contained in the petition.

- **b. Analysis and Resolution.** Once the petition has been received, the Secretary of the Committee will give such petition to an agency specifically created by the SHCP for its analysis and thereafter, the Committee will make its resolution. If the institution’s plan is approved, the Committee can place various conditions on its operation so long as such conditions do not contradict NAFTA or other legal provisions.
C. Cross-Border Insurance Services in Mexico. Mexico has agreed to allow U.S. and Canadian firms to provide certain cross-border insurance services currently restricted under Mexican law. Specifically, insurance of tourism-related risks in Mexico and related intermediary services. Mexico also will permit Mexican consumers to purchase insurance from U.S. and Canadian firms mainly in transportation and related areas. Mexico also has reserved certain other restrictions on cross-border insurance services under existing law.

3. Financial Services under NAFTA. NAFTA has liberalized trade and investment in financial services among the three NAFTA countries, particularly in Mexico. NAFTA addresses new topics, such as cross-border trade in financial services, and establishes broad principles governing all types of financial services (whether now existing or developed in the future). Even before NAFTA, the Mexican financial services market experienced a gradual liberalization, generally in favor of foreign financial entities, since the enactment of the Banking Institutions Law which entered into effect on January 1, 1990.

A. Scope. NAFTA covers: (i) Regulated financial institutions from another NAFTA country; (ii) Investments in financial institutions by investors from another NAFTA country; and (iii) Cross-border trade in financial services.

Each NAFTA country: (i) must ensure that its "measures" (general and local laws and regulations) conform to NAFTA principles (such as national treatment, most-favored-nation treatment, market access, cross-border services, and transparency) unless the NAFTA country has "reservations" in a special list. Canada, the U.S. and in particular Mexico, have all taken reservations; and (ii) a NAFTA country can also take future actions inconsistent with NAFTA standards ("exclusions") in areas such as monetary, credit, or exchange rate policies, for "prudential" reasons (i.e. for safety and soundness).

B. Definitions. A "Financial Service" is any service of a financial nature, including those "incidental or auxiliary", provided by a financial service provider, except for services provided by government-related entities or backed by government.

A "Financial Institution" is an authorized entity, governed or supervised ("regulated") as such under the laws of a NAFTA country. A "Financial Service Provider" may or may not be regulated depending upon the type of financial service to be provided.

An "Investment" is almost any interest (such as equity investments and tangible or intangible property) in a business allowing the holder to a share income or profits of the business. Investments do not include loans to NAFTA country governments or their agencies.

An "Investor" is any individual, company, or government agency from a NAFTA country that makes an investment.

C. Rules of Origin. To qualify under NAFTA, financial institutions, financial service providers, investors or their investments must satisfy "rules of origin" specified by each NAFTA country. Generally, a NAFTA country may deny the benefits of NAFTA to financial service providers that: (i) are owned or controlled by nationals or entities of a non-NAFTA country; and (ii) which have no substantial business activities in the territory of any NAFTA country.


a. Standards of treatment. Financial institutions, cross-border financial service providers, and investors and their investments from one NAFTA country will be given in another NAFTA country both: (i) "national treatment" and (ii) "most-favored-nation" treatment.

i. "National treatment:" A treatment no less favorable than the treatment given to its own investors, their investments, and financial institutions.
ii. "Most-favored-nation:" One NAFTA country will give to another NAFTA country a treatment no less favorable than the treatment given to any financial institutions, cross-border financial service providers, investors and investments of another NAFTA or non-NAFTA country.

NAFTA also requires that whenever a NAFTA country implements the prudential measures of another NAFTA country (i.e. disclosure agreement for securities offerings), the country implementing such measures must allow any other NAFTA country to negotiate for similar treatment.

b. Market Access. Each NAFTA country must permit investors from other NAFTA countries to establish financial institutions in its territory and expand their operations throughout its territory. Currently, NAFTA countries may restrict cross-border branching by requiring separate incorporation for financial institutions in their territory.

If a NAFTA country requires a financial service provider to be a member or participate in a self-regulatory organization in order to provide financial services, then that organization must abide by all the obligations of NAFTA. A "self-regulatory organization" is any non-governmental body which has authority to regulate or supervise financial service providers (i.e. a securities exchange or clearing agency).

NAFTA countries have made a number of specific commitments and reservations to the Market Access guidelines. Further below (Section 3. Financial Services in Mexico) are the basic provisions relating to Mexico.

c. Cross-Border Financial Services. Cross-border financial services basically include two separate aspects: (i) mobility of provider: ability to sell financial services in a jurisdiction where it has no place of business; and (ii) mobility of consumer: ability of a consumer to purchase services from a provider located outside the consumer's residence. These aspects are addressed in different ways.

Each NAFTA country has agreed to a "standstill" obligation with respect to any other measures regulating cross-border trade in financial services by cross-border financial service providers of another NAFTA country. A NAFTA country may maintain its existing measures regulating cross-border financial services and mobility of providers, but may not adopt any new restrictions on cross-border services permitted beginning on the date NAFTA enters into force, except to the extent set out in that country's reservations. However, as an exception, Mexico made a commitment to liberalize certain cross-border insurance services.

NAFTA countries have agreed to the mobility of consumers by permitting its citizens and residents to purchase financial services from any financial service provider located in the territory of another NAFTA country and which satisfies the rules of origin.

d. New Financial Services and Data Processing. NAFTA countries have agreed to permit regulated financial institutions from other NAFTA countries to provide new financial services of a type similar to the services that they are allowed to provide in their country of origin as regulated institutions, in like circumstances, under their domestic law.

A prior authorization may be required, but it may be refused for "prudential reasons" (i.e. safety or regulatory concerns). Such service provider may be required to satisfy certain legal formalities (i.e. provide the new service through a bank or separate subsidiary).

Each NAFTA country has agreed to permit regulated financial institutions from other NAFTA countries to transfer information for data processing in and out of the host country’s territory.

e. Staffing. A NAFTA country may not require a financial institution controlled by persons from another NAFTA country to employ individuals of any particular nationality, or that more than a simple majority of the board
of directors of such institutions be composed of local citizens and/or residents. The U.S. has taken a limited reservation to these provisions to preserve citizenship and residency requirements for national bank presidents and directors under existing law.

f. Investments in Financial Institutions. Each NAFTA country may impose special requirements (such as incorporation, residency requirements for investors, or information) relating to investments by investors from other NAFTA countries, provided they do not impair the benefits of NAFTA.

g. Reservations and Commitments. NAFTA countries made various reservations addressing differences in legal regimes and objectives. The reservations were worded broadly as statements of general principles. Mexico has the most lengthy and detailed reservations defining how Mexico is to open its financial markets institutions to U.S. and Canada. However, Mexico did not make any reservations for state measures under the Financial Services Chapter unlike the U.S.

Annex VII of the NAFTA sets forth important commitments by the three countries that further modify or expand provisions of the Financial Services Chapter, particularly regarding market access. The difference between "reservations" and "commitments" is not always clear in the Annex text.

h. Exclusions. NAFTA also provides for exclusions for certain measures. Generally, exclusions are broader than reservations. They exempt future as well as existing measures, and provide a much broader range of exceptions from NAFTA provisions and standards. Exclusions permit each NAFTA country to exercise important regulatory, economic policy, and government powers unfettered by NAFTA.

Nothing contained in NAFTA shall be construed as preventing a NAFTA country from imposing measures for "prudential" reasons or in pursuit of monetary and related credit policies or exchange-rate policies. This is often referred to as the "prudential carve-out" provision, which grants each country important flexibility to regulate and supervise financial institutions and markets.

These prudential measures may include those taken for the protection of investors or depositors, to maintain the safety and soundness of financial institutions, or to ensure the integrity and stability of the country’s financial system. Such measures must be of general application and non discriminatory against persons from other NAFTA countries.

Among other exclusions and measures that a NAFTA country may adopt are: (i) for balance of payments reasons in case of serious balance of payments difficulties or the threat thereof, and the measures to conform to International Monetary Fund rules; (ii) necessary for the protection of national security; and (iii) (a) retirement and statutory social security plans or (b) any activity or service for the account of, with the guarantee of, or using the financial resources of a government entity.

i. Administration and Dispute Settlement. NAFTA establishes a Financial Services Committee under the overall supervision of the Free Trade Commission which is the body in charge of administering NAFTA.

The Financial Services Committee is composed of financial services regulatory officials from each of the three NAFTA countries. This Committee will supervise the implementation of financial services guidelines to which a NAFTA country may refer, and will participate in financial services dispute settlement procedures.

These dispute settlement procedures are basically the same as those for the rest of NAFTA, but with the following modifications. The procedures involve several stages, invoked successively as the dispute continues over time.

A NAFTA country may first request consultations with one or more of the other NAFTA countries on any matter arising under NAFTA affecting financial services through designated financial services regulatory authorities.
If consultations fail to resolve the dispute, any NAFTA country may call upon the Free Trade Commission to assist in settling the dispute.

If the Commission cannot resolve the dispute in a mutually satisfactory manner, any NAFTA country involved may request the establishment of an arbitral panel composed of five independent financial services experts, selected by the disputing countries, to hear the dispute.

The arbitral panel will report its preliminary and final findings to the Free Trade Commission. The Commission will determine how to resolve the dispute through specific recommendations. If the recommendations are not followed, the prevailing party may retaliate by denying the same benefits in its own equivalent financial services sector.

If a NAFTA country complains against a measure of prudential regulation or monetary policy, the arbitral panel must submit the issue of the validity of that defense for decision by the Financial Services Committee.

Disputes for violations of NAFTA may be brought only by each NAFTA country’s Governments against another NAFTA country. An exception is the so called "investor-state disputes" brought under the Investment Chapter, when a private investor may bring a claim directly against a NAFTA country for violation of certain provisions of the Investment Chapter.


A. Foreign Investment Law. The FIL provides that the area of electricity is restricted exclusively to the Mexican Government. Related activities, which were previously conducted solely by Mexican owned businesses, such as the construction of electricity generating plants, electricity conduction lines and networks, and electrical installations in buildings, may now be conducted by businesses owned up to 100% by foreign investors.

B. Changes under NAFTA. NAFTA has lifted some of the restrictions on foreign ownership mentioned above. Public electrical service remains exclusively reserved to the Mexican Government, in accordance with the Constitution (NAFTA, Annex III-A2).

a. Liberalization of Investment. Since January 1st, 1999, foreign investors are allowed to own, without the need to obtain a favorable ruling from the NCFI, up to 100% of Mexican companies that perform the following activities: (i) Construction of Electricity Generation Plants; (ii) Construction and Maintenance of Electricity Conduction Lines and Networks; (iii) Electrical Installations in Buildings; and (iv) Construction Activities, Not Elsewhere Classified (NAFTA, Annex I - Mexico).

b. NCFI Review of Certain Acquisitions. If a foreign investor acquires more than 49% of a Mexican company that is owned or controlled by Mexican nationals and the value of the company’s assets exceeds a minimum threshold amount, the acquisition is subject to review by the NCFI.

Note: The threshold amount was US$25 million for the first three years of NAFTA (1994-1996); US$50 million for the next three years (1997-1999); US$75 million the following three years (2000-2002); and US$150 million thereafter, adjusted annually for inflation. NAFTA, Annex I - Mexico.

The NCFI’s review will be based on three factors: the investment’s effects on employment and training, its technological contribution, and, in general, its contribution to increase Mexican industrial productivity and competitiveness (NAFTA, Annex I - Mexico).
C. Electrical Power Legislation.


Mexico has historically restricted electrical power production and related activities to the State. The Electrical Power Law, in accordance with Article 27 of the Mexican Constitution, reserves the generation, conduction, transformation, distribution, and supply of electricity for public service exclusively to the Mexican Government. The Regulations at the FIL allow individuals to generate electrical power for certain specific purposes. The Constitution also prohibits the Government from granting concessions to private individuals to supply electricity to the public.

b. Amendments to the Electrical Power Law. Despite the constitutional restrictions on public electricity service, the Mexican Government has gradually liberalized the Electrical Power Law to facilitate private sector involvement in the electricity industry to increase its efficiency and competitiveness.

The Regulations for the Electrical Power Law regarding Self-Supply ("Self-Supply Regulations", published in the Official Federal Gazette on May 31, 1993), deal with the issuance of "self-supply" permits to allow private individuals and groups to generate electricity to satisfy their private electricity needs.

The Electrical Power Law itself was amended in December, 1992 to allow private electricity production through the following activities, with prior permit from the Ministry of Energy ("the Ministry") and the advice of the Federal Electricity Commission ("CFE"): (i) Electrical generation for self-supply, co-generation, or small production; (ii) Production of electrical power for sale to the CFE ("independent production"); (iii) Generation of electrical power for export derived from co-generation, independent production, and small production; (iv) Importation of electrical power by individuals or companies for their own needs; and (v) Generation of electrical power for emergency use in case of interruptions in public service (these provisions were unchanged by the "1993 Regulations" outlined below).


c. Opportunities for Private Electricity Generation. As of January 1st, 1999, foreign investors are allowed to own, without the need to obtain a favorable ruling from the NCFI, up to 100% of Mexican companies that perform the following activities: (i) Construction of Electricity Generation Plants; (ii) Construction and Maintenance of Electricity Conduction Lines and Networks; (iii) Electrical Installations in Buildings; and (iv) Construction Activities, Not Elsewhere Classified (NAFTA, Annex I - Mexico).

The FIL Regulations confirm what the Electrical Power Law already indicated, that private parties may obtain permits to produce electrical power, under certain conditions, including making their surplus available to the CFE, for (NAFTA, Annex I - Mexico):

i. Self-supply. The electricity must be produced only for the individual or company’s own needs and may not be sold or transferred to third parties other than the CFE.

Permits will be granted as long as the Ministry does not consider that the production of energy would place the country at a disadvantage. Before the 1992 amendments, the Ministry would grant permits only if normal supply by the CFE was impossible, inconvenient, or less efficient than private production.
A group of consumers can obtain a permit to operate an electrical power plant to satisfy their collective electricity needs provided that they form a corporation to operate the center and that each member of the group is a co-owner of the corporation. The corporation may not provide electricity to non-members of the group without express permission of the Ministry. A permit is not required for self-supply of less than 0.5 MW or of any amount reserved exclusively for emergency use.

ii. Co-generation. Permits are available for co-generation, which is defined as the direct or indirect production of electrical power using secondary thermal energy or fuels produced by industrial processes. The electricity produced must be used to satisfy the needs of associated establishment (host industry). The co-generation process must also be more economically efficient than conventional generating plants. The permit holder need not be the same entity that produces the secondary thermal energy or fuels.

iii. Independent Production. Private individuals and entities may obtain permits to generate electricity for sale to the CFE or for export. The capacity of such plants may exceed 30 MW. The Ministry and CFE are required to consider private power purchases in its long term planning and its decisions to build new capacity for public electricity service. To obtain a permit, independent producers must:

(a) be individuals or corporations organized under Mexican law;

(b) be domiciled in Mexico; and

(c) either: i) agree to sell their electrical power production exclusively to the CFE under long-term contracts to meet the CFE's identified needs; or ii) export all or part of such production with the prior approval of Ministry.

iv. Small Production. Mexican individuals or entities domiciled in Mexico, can obtain a permit to produce electrical power on a small scale for:

(a) projects to produce power for sale to the CFE with a total capacity not exceeding 30 MW;

(b) projects to supply electricity for personal consumption to small rural communities or isolated areas, provided that the interested parties create a cooperative, partnership, corporation, or other arrangement and that production does not exceed 1 MW; and

(c) projects to produce power for export, within the maximum limit of 30 MW.

v. Import/Export. Finally, private parties may obtain a license to produce electricity for export by means of co-generation, independent production, or small production. Individuals and companies may obtain an import permit, but only for purposes of self-supply of their own needs.

d. Conditions Regarding all Permits.

i. Limited sale or transfer rights. Permit holders may only sell or transfer the electricity they produce as expressly provided for in the law.

ii. Scope of Activities Permitted. Permits to generate electrical power may also include the right to transport and distribute power as well. Permit holders may also use the national electrical system network with CFE permission for an agreed-upon consideration, provided that such use would not jeopardize public power service or affect third parties.
iii. Emergency Service. All permit holders must provide electricity for public use when the public service is interrupted. In such cases, the permit holders will be entitled to compensation.

iv. Permit Term. Permits for independent production are issued for a 30 year renewable term, while all other permits are issued indefinitely so long as all applicable legal provisions are satisfied.

v. Transfer of Permits. The Ministry of Energy may authorize the transfer of permits.

vi. Compliance with Mexican Mandatory Standards. All permit applicants and holders must comply with technical rules issued by the Ministry of Energy regarding the contents of the permit application and the operation of the resulting electricity production facilities.

The Ministry of Energy’s technical rules are contained in the Official Mexican Norms (the "Norms") published on occasion in the Official Federal Gazette.

According to current Norms, permit applicants must prepare a report describing their energy needs and the technical details of their planned project. The Norms also establish a series of rules regarding the planning, design and operation of power generation facilities.

e. Activities that do not Require a Permit. A permit is not required for self-supply of less than 0.5 MW or for emergency power generation.

f. Construction of New Facilities. The CFE is responsible for providing electrical power service to the public, which includes any construction, installation, or other works necessary to plan, operate, and maintain the national electrical system. The CFE is authorized to contract with public and private entities to provide such service.

The opportunities for foreign suppliers, however, could potentially be limited by a provision of the Electrical Power Law which requires the CFE to give preference to Mexican parts suppliers whenever possible. Although this provision was not changed by the 1992 amendments, it also is not mentioned in the 1993 Regulations. In any case, foreign investors can avoid any preference for Mexican suppliers by subcontracting with Mexican companies with CFE contracts, or by investing directly in Mexican companies that carry out such contracts.

The CFE has entered into a number of contracts with various consortia or joint venture groups involving Mexican and foreign companies to expand Mexico’s electrical power capacity, i.e. build-lease-transfer (known in the trade as "BLT") projects for the construction of Power Plants.

The Regulations for the Electrical Power Law regarding Contributions (published in the Official Federal Gazette on November 10, 1999), provides that private entities or individuals may request the creation or modification of certain electrical facilities. Such Regulations also provide the method to calculate the Contributions to perform such specific works.

g. Sale of Electrical Power and Capacity of the CFE. As mentioned in the preceding Sections (Construction of New Facilities), the Electrical Power Law authorizes the CFE to contract with private parties to provide electricity to the public at the lowest cost. Private parties may generate electricity for sale to the CFE through (i) small-scale production, (ii) independent production, (iv) co-generation, and (v) self-supply (see above). They may sell all of their generating capacity or just their surplus capacity to the CFE.

The following is a summary of the CFE purchasing procedures which are established in the 1993 Regulations to the Electrical Power Law.
i. **Bids for the Addition or Substitution of Generating Capacity.** If the Ministry of Energy determines that private electricity supplies are necessary to satisfy Mexico’s energy needs, it may authorize the CFE to purchase electricity from private producers through a competitive bidding process. The 1993 Regulations establish the procedures for the bidding process, e.g., the call for bids, their evaluation, and written explanations of the CFE’s final decision. The CFE may purchase electricity from private producers with a generating capacity of 20 MW or less without soliciting bids.

ii. **Terms of the Purchase Agreements.** The CFE will enter into agreements for the purchase of electric power and capacity commitments from holders of generation permits who: (i) are successful bidders in the process described above; (ii) have an energy surplus of 20 MW or less; and (iii) are otherwise authorized to sell electric power to the CFE.

The parties are free to establish the agreement term, provided that it does not exceed the term of the seller's generation permit.

The CFE will enter into a separate agreement for each generation plant, even if the CFE purchases electricity from several plants owned by the same person. The agreements should include the following:

(a) Generation capacity offered to the CFE;

(b) Terms and conditions regarding the generation capacity and delivery of power in ordinary and emergency situations;

(c) Formulas to determine payment for generation capacity and electrical power deliveries in ordinary and emergency situations, incentives or adjustments in the generation capacity offered to the CFE, and updating factors for the payments;

(d) Term of the agreement;

(e) Technical conditions of the electrical power, including the interconnection point for delivery, measurement of the power, and tension;

(f) Contractual penalties for non-performance of the agreement; and

(g) Governing jurisdiction (i.e., the Mexican Federal Courts) and, if applicable, arbitration rules for technical matters.

Agreements for the purchase of surplus power from permit holders with a generation capacity of 20 MW or less or other small purchases need only to include the terms described in sections (iv) through (vii) above.

**Permit holders are responsible** for providing, operating, and maintaining the installations required for the transformation, measurement, protection and control of the electrical power in accordance with the Official Mexican Standards and the CFE’s specifications, and delivering the power subject to the operation rules of the National Electric System and the applicable provisions of the Regulations.

**The CFE is responsible** for making payments on the day and in the manner agreed upon, for notifying the permit holder of any temporary suspension in the delivery of electrical power resulting from the CFE’s maintenance or repair operations (except in emergencies), and for giving timely notice to the permit holder of the deliveries foreseen.
Both the permit holder and the CFE shall be responsible for installing and adapting their protection and control equipment to avoid possible damage to their installations due to internal or external disturbances. Any electrical power and capacity supplied by the permit holders in addition to that agreed upon with the CFE shall be purchased by the CFE at market value.

iii. **Compensation.** The CFE shall make one payment for capacity, adjusted by an availability factor, and another for power delivered at the interconnection point. The payments for capacity and power delivered shall reflect the permit holders’ variable and fixed costs, including return on investment, related to both generation and transmission.

Payments for capacity will be adjusted each month by a coefficient based on the availability factor observed during the month.

The agreement may include formulas to update the payments, taking into account fuel prices, among other factors.

iv. **Delivery Rules.** Delivery of electrical power to the public service network must comply with the operation and delivery rules of the National Electrical System established by the Ministry of Energy in accordance with the Electrical Power Law and Regulations.

Electrical power deliveries to the National Electrical System from plants owned by the CFE and private parties are to be accepted by the CFE according to the short term total cost or price offered, with strict priority given to the lowest cost electrical power. The CFE must follow this rule, except for safety reasons or in a technical emergency.

The CFE will send a monthly notice to each of the private producers with whom it has entered into electricity purchase agreements of its estimated power needs from each producer for the following three (3) months. This notification does not legally bind the CFE.

Each of the private producers, on the other hand, shall inform the CFE, five (5) days before the beginning of each period (as determined by the CFE), of their estimated costs and/or prices for that period. In the case of producers who have won contracts with the CFE through the bidding process, the estimate shall be of the short term total cost of electrical power for that period (according to the formulas described above). All other producers (e.g., sellers of surplus production) are to estimate the price and maximum amount of electrical power to be delivered at base, intermediate, and peak hours during the period.

Based on this information, the CFE will send a delivery program to each private producer with detailed, hour-by-hour information of deliveries to be made on the following day. The CFE is to send the program no later than by 3:00 p.m. on the preceding day.

v. **Transmission.** To deliver electrical power to the National Electrical System, private producers may: (i) request the transmission services of the CFE; or (ii) build their own transmission lines, provided they are not interconnected with the public service network and they comply with the Official Mexican Standards. In the former case, the CFE may use existing installations, where available, or may agree with the private producer on the construction of new installations, sharing the construction costs.

The private producers shall compensate the CFE for its transmission services. The charges shall be based on the CFE’s actual cost to provide the service, considering technical solutions that minimize the cost, such as exchange of electrical power among different control areas and other solutions proposed by the private producer. The Ministry of Energy may intervene to resolve disputes between the CFE and private producers over the charges.
vi. Sale of Electrical Power to Permit Holders by the CFE. The CFE shall provide backup capacity to private producers through supply contracts as needed, except where prevented by a technical or economic impediment as described in Article 20 of the Regulations. One "backup rate" shall apply to purchases by all private producers.

vii. Inspections. The Ministry of Energy is authorized to inspect the private producers' facilities as required to oversee compliance with the Electrical Power Law and Regulations. Inspectors must present an inspection warrant with the inspection date, place to be inspected, duration of the inspection, purpose of the visit, and other pertinent circumstances. Upon presentation of such documentation, the inspector shall have free access to the facilities, premises, and installations to be inspected, as well as to any information requested by the inspector.

h. Administrative Proceedings and Sanctions. The Regulations establish rules for the application of sanctions for violation of the Electrical Power Law and Regulations. In the case of illegal generation and/or sale of electricity, these sanctions may include a fine of up to 100 times the annual minimum wage for the Federal District for each kilowatt of electrical power sold illegally, or for each kilowatt of generating capacity. The private producer will have the right to plead its case in administrative proceedings before the Ministry of Energy within fifteen days of receiving notice of a resolution against it.

i. The Possible Bills and Amendments. On February 2, 1999, our former President Ernesto Zedillo announced a Bill to amend the Mexican Constitution (the "Amendments") regarding private investment in the Electric Industry, wherein Articles 27 and 28 provide for the regulation of natural resources and determine which activities are exclusively for the Mexican Government and the Mexican Nationals. These Amendments were aimed to:

(i) satisfy the electrical needs for the forthcoming years, and
(ii) reduce the Federal Budget.

The restructuring of the Mexican Electrical Industry would be done in three phases, as follows:

i. The CFE and "Luz y Fuerza del Centro" ("LFC"), the Federal Entity generating electricity for Mexico City and the States of Morelos, Hidalgo and Puebla, will be divided into Local Agencies. The current National Center of Energy Control, the Federal Entity performing the electricity distribution, will become the Operating Center of the National Electrical Center ("CONSEN") having the following functions:

(a) Electrical Transmission. The generators will deliver the electricity to the CONSEN. Thereafter, the CONSEN will transmit it to the distributors and traders located at the places where such electricity is needed. This activity will remain under the Government control to avoid distrust of competition among the generators and distributors; and

(b) Finance Authority. The CONSEN will receive the repayments from the distributors and traders and will deliver them to the generators.

ii. The Private Companies will start to generate and trade electricity competing with the government companies. For such purpose the National Bank of Foreign Trade (Bancomext) will provide financing to these private investors. These private companies could have up to 100% foreign investment; and

iii. The Government will sell through public bidding its electrical assets and companies. The Government will also place securities of electrical companies in the Mexican Stock Market.
Under these amendments, the role of the Mexican Government will be:

(a) To regulate the Mexican Electrical Industry and oversee it through the CFE and the CONSEN;

(b) Prepare specific power programs for the country side;

(c) Grant subsidies when necessary; and

(d) Operate the Nuclear Energy Plants.

These Amendments were intended to be in force around 2001; the Federal Government would restructure the Electrical Industry to adjust it there from. Since December 1, 2000, when Vicente Fox took the position of President of Mexico, he has been lobbying in support of the Amendments to the Electrical Power Law with the Mexican Congress. However, there is still political "resistance" to open the Power Sector to private investment.

At any rate, these Amendments have the support of the business sector of Mexico. However, President Fox still must promote the reasons behind these Amendments before Congress.

5. Mining. The Mining Law, which entered into effect on September 24, 1992 (the "Mining Law"), and the Regulations of the Mining Law, which entered into effect on February 15, 1999 (the "Mining Regulations") significantly deregulate investment in the Mexican mining industry by greatly simplifying the bureaucratic steps required to obtain, maintain, and convey mining company shares and concessions. This offers greater security to investors, encouraging both foreign and domestic investment in the mining industry.

A. General Provisions of the Mining Law. For purposes of the Mining Law, the following terms are defined:

a. Exploration. Identification, measurement and valuation of mineral deposits whose exploitation is economically feasible;

b. Exploitation. Extraction and separation of minerals from the ground; and

c. Processing. Preparation, treatment, first-hand smelting, and refining to obtain minerals or other extracts or to increase the concentration and purity of mineral content.

The Mining Law defines the principal activities, minerals, and other substances regulated therein. The Mining Law also specifies the minerals or substances that may not be subject to concessions, which among others include: petroleum, hydrocarbons (solid, liquid or gaseous), radioactive minerals, products derived from the decomposition of rocks that may be exploited from the surface, etc.

B. Authority of the Ministry of Economy. The Ministry of Economy is the government entity in charge of mining regulation in Mexico.

The Mining Law confers upon the Ministry of Economy, among other powers, the authority to formulate, promote, coordinate, and maintain programs or measures for the promotion of small, medium-scale, and public sector mining operations. The Ministry of Economy is also responsible for evaluating new mining projects related to the mining-metallurgical industry, and submitting them for Federal Executive Branch approval, considering the benefit of the project to the investor and to the Nation.

The Ministry of Economy, with the assistance of the Mineral Resources Board, is empowered by the Mining Law to function as an agency to provide advice and support of the mining-metallurgical industry as a whole.
C. Concessions. The Mining Law states that mining concessions are to be granted by the Ministry of Economy and are to be of two types: (i) exploration; and (ii) exploitation. Such concessions can be exploited by: (i) Mexican citizens (ii) “ejidos” ( communal farms) and agricultural communities, and (iii) Mexican companies in which foreign investors can own equity as described below (section c(i)).

Concessionaires that process the minerals that they extract must notify the Ministry of Economy of the commencement of mineral processing operations. Once such notice is given, the Ministry of Economy requires concessionaires to submit statistical, technical and accounting reports, notify the Ministry of Economy of any radioactive materials discovered and, in some cases, dedicate at least 15% of processing capacity to the processing of minerals extracted by other small, medium-scale, and public sector mining operations.

Concessions are granted to the first applicant who meets the conditions and requirements of the Mining Law and its Regulations except in the case of:

i. Mexican Maritime Zones (concession must be granted by public bidding);

ii. Mineral Reserve Zones;

iii. Areas already subject to a Concession or assignment;

iv. Areas for which a Concession or assignment is in process;

v. Areas covered by concessions which were granted by public bidding, then canceled;

vi. Concessions substituted for Concessions granted by public bidding, then canceled; and

vii. Areas that were not given in concession because a public bid was declared void.

a. Exploration and Exploitation Concessions. In general terms, the Mining Law streamlines the bureaucratic process for granting exploration and exploitation concessions.

i. Exploration Concessions. Exploration concessions now have a non-renewable 6 (six) year term from the date of registration with the Public Mining Registry. They may be replaced with one or more exploitation concessions provided that: (i) the holder of the concession has not committed any act which constitutes grounds for cancellation under the Mining Law; (ii) the holder applies for the new exploitation concession(s) before the old exploration concession expires; and (iii) the territory of the new exploitation concession is entirely within the area of the exploration concession that it replaces.

Exploration concessions granted before the Mining Law entered into effect will remain valid and may be replaced with exploitation concessions according to the terms set forth in the preceding paragraph. The Operations Plans required by the former law will no longer have any legal effect, therefore concessionaires need not adhere to the plans approved by the government.

ii. Exploitation Concessions. Under the Mining Law, exploitation concessions now have a term of 50 (fifty) years starting on the date of their registration with the Public Mining Registry. Such concessions may be renewed for an identical term if the concessionaires: (i) have not committed any act constituting cause for cancellation as provided in the Mining Law; and (ii) apply for the renewal within five years prior to the expiration of the concession.
b. **Obligations of the Concession Holders.** The Mining Law requires concessionaires to submit an annual report to the Ministry of Economy, each May, detailing the mining activities of the prior calendar year.

Persons who, at the time the Mining Law entered into effect, were under contract with concessionaires to conduct exploitation operations within territories covered by mineral set asides or by the concessions which replace them, may continue operating under such contracts until the operations are completed. These contractors will have a preferential right to obtain the corresponding mining concession if the territory subject to the contract remains free of any new concession and such contracts were performed. This right may be exercised once the decree that the land is free of concessions takes effect.

c. **Concession Holders.** According to the Mining Law, a company with legal capacity to hold mining exploration and exploitation concessions are those organized under Mexican Law with the following characteristics: (i) their corporate purpose includes exploration or exploitation of the specific minerals or substances in question; (ii) their legal domicile is within the Mexican Republic; and (iii) their foreign equity, if any, conforms to the provisions of the corresponding law.

i. **Foreign Investment in Concessionaire Companies.** In accordance with Article 4 of the FIL, Mexican concessionaire companies may have up to 100% of foreign equity. This represents a substantial improvement over the previous Foreign Investment and Mining Laws, which placed cumbersome restrictions on all foreign investment in Mexican companies holding operating exploration and exploitation concessions.

d. **Transfer of Concessions.** The Mining Law allows for the transfer, as of right, of title or the underlying rights to mining concessions to persons with legal capacity to acquire them, except when the concessions relate to: (i) Mexican maritime zones; (ii) undersea shelves of islands, islets, or reefs; (iii) the ocean floor; and (iv) the subsoil of the exclusive economic zone.

Upon transfer of title to a concession, the transferee will subrogate the rights and obligations of the previous concessionaire. The transferee is responsible to ascertain whether the concession remains in force and that the concessionaire is in compliance with its obligations. The Ministry of Economy, upon petition and at the expense of the interested party, can issue a verification of the aforementioned.

Any acts, contracts, and covenants with respect to the transfer of title to a concession or of the rights derived therefrom, as well as any disputes that arising thereunder, if not covered by the Mining Law, will be governed by commercial corporate laws.

Once registered with the Public Mining Registry, the transfer will have legal effects as against third parties.

D. **Set Asides.** The Mining Law states that mining set asides are to be issued solely to the "Consejo de Recursos Minerales" (Mineral Resources Board) through the Ministry of Economy. Mining set asides will be granted for exploration within the national territory to identify and measure the Nation's potential mineral resources. Set asides certificates will be published in the Official Federal Gazette.

Set asides will have a non-renewable term of 6 years which begins on the date of the certificate's publication in the Official Federal Gazette, will be non-transferable, and may not be subject to any encumbrance.

The Mining Law cancels all set asides in favor of the "Comisión de Fomento Minero" (Mining Development Commission) and assigns the lands covered by such set asides, as well as all the Commission's property, to the Mineral Resources Board or to the Mining Development Trust at the discretion of the Ministry of Economy.
E. Reserves. The Mining Law permits the creation of "Reserved Mining Zones." The Reserved Mining Zones are created by Executive Branch decree for the purpose of satisfying the country's future mineral needs, based on the public interest or for strategic reasons.

Only those zones previously explored by the Mineral Resources Board through set asides may be designated as mineral reserves. Such designation is based on the mineral potential of the zone, as ascertained through exploration operations, and is justified by the public or strategic interest. As noted above, no concessions or set asides are granted for these Zones.

F. Transfer of Shares. As discussed above, the new Mining Law eliminates the prerequisites and notices previously required by the Ministry of Economy for the transfer of concessions or shares in a mining company. Such transfers need only comply with applicable laws. The only applicable provision of the Mining Law is Article 40, which declares null and void any transfers of title to mining concessions or of any rights derived therefrom when:

a. the transferee lacks legal capacity to obtain the concessions or rights; or

b. the concessions involve territory within Mexican maritime zones, undersea shelves of islands, islets and reefs, the ocean floor, and the subsoil of the exclusive economic zone.

G. Invalidity and Cancellation of Concessions and Suspension of Operations. The Mining Law lists the following as grounds for invalidity, cancellation, or suspension.

a. Concessions are deemed invalid when:

i. The concessionaire attempts to utilize the concession, from the date of its issuance, to extract minerals or substances that are not subject to the Mining Law;

ii. The concession is issued to persons who lack legal capacity according to the Mining Law; and

iii. The mining lot includes, partially or entirely, land that is not free of encumbrances when the application is filed, even if land is subsequently declared to be unencumbered by official decree.

b. Concessions are cancelled when:

i. the concession term expires;

ii. the concessionaire presents sufficient and legally-recognized grounds for ceasing operations;

iii. an exploration concession is replaced with an exploitation concession or the territory subject to the concession is reduced, divided, or combined with another lot;

iv. minerals or substances not subject to the Mining Law are exploited;

v. exploration or exploitation operations are reported but not carried out according to the terms and conditions set forth in the Mining Law and its Regulations;

vi. radioactive materials discovered during the course of operations are disposed of by the concessionaire;

vii. non-payment of mining duties or the premium for discovery of minerals or substances other than those covered by the concession;
viii. non-compliance with the Ministry of Economy’s technical specifications in the performance of exploration or exploitation operations in territories subject to petroleum set asides;

ix. exploration or exploitation operations are undertaken in or around populated areas, communication routes (highways, railroad tracks, etc.), dams, canals, and other public works without permission of the corresponding local government entities;

x. non-adjoining mining lots are combined to demonstrate that they do not constitute a mining or mining-metallurgical unit from a technical or administrative viewpoint; or

xi. the concessionaire loses the legal capacity required for mining concessions.

c. Operations are suspended if (and for as long as):

i. the lives or physical safety of workers or the public are endangered; and

ii. public or private property has been or might be damaged.

H. Public Mining Registry and Mining Cartography. The Mining Law provides for a Public Mining Registry administered by the Ministry of Economy, in which certain acts and contracts of the mining concessionaires must be registered.

6. Telecommunications. The Federal Telecommunications Law ("FTL") was passed by the Mexican Congress at the end of May, 1995. Its principal purpose is to regulate the use, enjoyment and exploitation of: (i) radio-electric spectrum allocations; (ii) telecommunication networks; and (iii) satellite communications.

The main goal of the FTL is to promote the avoidance of telecommunications monopolies, equal treatment-equal access rules for the market, and the creation of universal telecommunications services for all competitors in the Mexican market. Based on this goal the current Presidential Administration has launched one of the most aggressive telecommunications projects worldwide, known as "e-Mexico." The principal purpose of e-Mexico is to provide internet connectivity not just for the principal markets, but also to rural areas and small towns where Internet can become a source of universal communication, education and economic development.

The FTL has been recognized as a pro-competition law. Notwithstanding this consideration, Congress is currently discussing important amendments to the FTL, in order to foster such free competition and to ensure timely and effective application of its provisions.

A. COFETEL. The Ministry of Communications and Transport ("SCT") is the authority with jurisdiction over telecommunications. However, a Presidential Decree under the FTL created the Federal Telecommunications Commission ("COFETEL"). COFETEL was created to establish a relationship with the telecommunications industry and become aware of the issues, technological developments, markets and international regulations in this area. COFETEL is an independent agency ("Organismo Desconcentrado") with its own budget and authority. COFETEL is both: (i) "promoter" for the development of telecommunications services; and (ii) a "regulator" in the market, allowing telecommunications providers to compete on an equal opportunity basis with the dominating telecommunications service provider, Teléfonos de México, S.A. ("Telmex").

Even though COFETEL’s legal framework indicates that it is "independent," in practice, there is a lot of communication between the SCT and COFETEL to make joint decisions, including the granting of concession titles. Furthermore, COFETEL depends on the SCT to enforce its resolutions. This interdependency has created some animosity between the SCT and COFETEL.
B. Current Authorizations for Telecommunication Services. Currently, the FTL regulates the granting of the 3 (three) different levels of authorizations for telecommunications in Mexico:

a. Concessions, for the build-out and exploitation of Public Telecommunications Networks. Such Public Telecommunications Networks are those systems integrated by any transmission means such as channels or circuits which use frequency bands of radio-electric spectrum, satellite links, wiring, electric transmission networks or any other means of transmission.

The Concession is a grant by the Federal Government to allow, under certain legal scenarios, telecommunications services to be commercialized and rendered openly to the public. Examples of such services include long distance, local telephony, fixed and wireless communications, satellite services and the use of frequencies of the national radio-electric spectrum. The Federal Government will only call for a bidding process when the use of frequencies of the national radio-electric spectrum is involved in a specific service.

(i) Basic Telephone Services. Telmex, the former State monopoly which was privatized in 1991, currently dominates telephone service in Mexico. Although local service has technically been opened to competition, Telmex had remained as the dominant operator until the arrival of the new-comer Axtel, S.A. de C.V.

(ii) Long-Distance Telephone Services. Although the Government does not charge concession fees to those carriers that install and use fiber-optic cable, it charges fees for those using the radio electric spectrum or other technologies.

Radio-electric spectrum can be exploited by the private sector provided the interested party obtains a concession title to that effect. The concession title granted by the SCT for the exploitation of the Radio-electric spectrum will contain all of the additional requirements not contained in the FTL that the concessionaire must comply with. Such additional requirements concern the area of coverage, technicalities and obligations. The FTL divides radio-electric spectrum into:

(i) Free Use Spectrum;
(ii) Official Spectrum, reserved to the Federal, State or Local Government;
(iii) Experimental Spectrum, for scientific purposes or equipment testing;
(iv) Reserved Spectrum, frequency bands not assigned by the SCT and new technologies; and
(v) Specific Use Spectrum, for commercialization of telecommunications services by the private sector.

Concessions for the build-out and exploitation of Public Telecommunications Networks will be granted at no fee for 30 years, with renewable terms. Resale (assignment) of the concessions is permitted after three years with previous authorization from the SCT.

b. Permits, are those authorizations required to commercialize telecommunications services which do not fall under a Public Telecommunications Network that requires a Concession. Permits are given to such telecommunications services resellers for broadband services, public urban and rural pay-phones, prepaid air time for cellular telephones, and satellite broad-band services among others;

c. Registries for Value Added Services, in which specialized telecommunications services are offered and commercialized using the available infrastructure and connectivity of Public Telecommunications Networks (Concessionaries) such as Internet Services Providers ("ISP"), videoconferencing, and operator services, among others.

C. Permissible Foreign Equity. In general terms the Foreign Investments Law ("FIL"), establishes a limit of 49% to foreign ownership in telecommunications companies that operate under a Concession ("Concessionaires"), except for
the cellular telephone industry, where Foreign Investment is allowed up to 100% ownership.

Nevertheless, the FIL provides for a legal scenario to increase foreign capital participation in telecommunications if required, which is through Neutral Investments. Such Neutral Investments will not be considered as foreign ownership in Mexican companies. Neutral shares are defined as shares with rights to profits, but with limited or no corporate rights at all. These Neutral shares are not counted for purposes of the 49% foreign ownership capital limitation. The Neutral Share concept is discussed more fully within the Foreign Investments Section above (Section IV, 3H).

As for the telecommunications companies operating under Permits or Registries of Value Added Services, there is no limit to the participation of foreign investments.

D. Wireless Telephone Service: Advance Mobile Phone Services (AMPS) and Personal Communication Services (PCS). As of May 1, 1999, COFETEL instituted the Program “Calling Party Pays” (“CPP”, “El que llama Paga”), which made the cellular market grow from 3,349,000 users in 1998 to 19,396,000 in 2001, surpassing the number of current users of fixed-lines of 13,368,000 users. The Mexican Market is following the world tendency to use 100% digital network for cell phones. The Government restriction-free policy plus the "boom" of the CPP has increased the participation of several international cell phone operators such as Verizon Communications and Vodafone Group, PLC in Iusacell, and America Movil in Telcel (the major mobile operator in Mexico).

a. Wireless Fixed-Line. Wireless Fixed-Line operators must obtain a title of concession for rendering services. Wireless Fixed Lines have increased as an alternative for new operators such as Operadora Unefon, S.A. de C.V., and Axtel, who try to avoid paying for using Telmex's local loop.

b. Radio Communication (Trunking and Paging). Companies providing Trunking or Paging services must obtain a title concession or permit for using the corresponding frequency.

Recently, the use of paging has decreased due to the impact of the CPP, i.e. in 1998, there were 651,000 users of pagers, but in 2001 pager users fell to 471,000 and to 251,000 in October 2002.

The trunking market is different since Inversiones Nextel de México, S.A. de C.V. has introduced trunking devices with the capability of connecting to the fixed line network and with multiple services similar to the PCS at competitive rates. In this regard, Trunking use grew from 140,000 in 1998 to 272,000 in 2001 and to 624,000 in October 2002.

E. Satellite Communications. Satellites are no longer considered by the Mexican government to be strategic and protected sectors.

A concession title is required for occupying and exploiting geostationary positions and satellite orbits assigned to Mexico, and exploiting signal emission and reception and associated frequency bands of foreign satellites providing services in Mexican Territory.

The SCT will work with the FCC on reciprocity issues to permit U.S. Satellites to send their signals to Mexico and Mexican Satellites to be able to do the same in the United States.

Mexican companies, regardless of their foreign investment participation, will be authorized to send, receive and exploit foreign satellite signals transmitted to Mexico in accordance with international treaties that provide for reciprocity rights to Mexicans abroad.

F. Perfection of Agreements through Electronic means. The Federal Commercial Code, enacted in 1887, reorganized the perfection of commercial agreements for trading of goods and services through any remote
communication means (i.e. telegraph, courier, etc.). However, this Code was not intended for the technological developments known today.

In an effort to update Mexican Laws to the Global Market and Digital World, on May 29, 2000, the Federal Civil Code and the Federal Commercial Code were amended to include that communication through electronic means (i.e. e-mail or electronic documents) are: (i) a valid form for closing an agreement, and (ii) proof during trial, taking into consideration the reliability of the hardware and software in which the e-mails or e-documents where generated, sent, and stored.

The content of e-mail communications are now considered valid when they come from a system to which only the sender has access or a password.

The e-mail is deemed as received and therefore, it has legal effects, when: (i) the addressee receives the e-mail in an account and system previously agreed upon by the parties, or, in lieu thereof, (ii) the addressee acknowledges receipt of the e-mail in a different system.

If the sender of the e-mail requires confirmation of receipt, the e-mail is deemed received when the sender receives such confirmation.

If the Law requires further formalities to perfect a contractual agreement beyond mutual consent (even by e-mail), such as the involvement of an Authority or Notary Public, it is necessary to store all files to evidence that the mutual consent was reached.

This Amendment came together with another amendment to the Consumer Protection Law establishing that any e-trader has to follow the general principles of consumer protection, such as: (i) provide the consumer all information about the product/service, (ii) avoid misleading information, (iii) protect the information of the clients, (iv) refrain from sending unsolicited mail, etc.

This Amendment is drafted according to the UNIDROIT Model of E-Commerce Law integrating Mexico into the Worldwide movement of E-Law. However, this Amendment by itself, is not sufficient to solve many issues generated by E-Commerce and E-Business, such as:

a. How is jurisdiction determined regarding Agreements closed via the Internet? And, how will jurisdiction be enforced?

b. What are the applicable taxes on the purchase of goods and hiring of services over the Internet?

c. Which standards does an e-trader or Service Provider have to follow in relation to confidentiality on the Internet?

d. What is the limit for using intellectual property over the Internet?

e. What is the extent of liability for digital products?

Nevertheless, many of the issues are resolved by the rules of conflict of laws, using the Mexican Laws and the Treaties to which Mexico is a Party. But, the real problem is the enforcement of these Laws and Treaties, since the Judges would require special training on the essential technical aspects of the Internet, in order to reach the best resolution to these unexplored issues.
Similar amendments have taken place in the Civil Code for Mexico City and some of the Civil Codes for the States of the Mexican Republic, acknowledging the existence of electronic means, and assigning legal value to their communications.

**G. The Forthcoming Modifications to the Telecom Law.** Many forums are discussing the new Telecom Law, including lawmakers, telecom companies, technicians, COFETEL, COFECO, SCT, The World Trade Organization, the Telecom Chamber of Commerce, etc. However, there is no defined deadline or path for the new Law. One thing is certain, the New Law will have to take up many issues for the improvement of the Mexican Market, such as:

- technological convergence,
- re-allocation of frequencies,
- solving the by-pass problem,
- interconnection,
- universal service fund,
- 3G Services, and
- increasing the authority of COFETEL, among others.

**7. Railroads.** The Law Regulating Railroad Services was published on May 12, 1995. This Law covers the use, enjoyment and exploitation of: (i) railways that are general means of communications; (ii) public service of railroad transportation; and (iii) auxiliary services. The Ministry of Communications and Transport ("SCT") is the Ministry which oversees the compliance of the Law.

"Ferrocarriles Nacionales de México," a government owned entity, will continue to be in charge of providing railroad services until the corresponding concessions and permits are granted to private investors. All concessions in railroad services will be granted to Mexican companies. However, such Mexican companies may have up to 49% foreign equity in its capital stock or a higher percentage with the prior approval of the Foreign Investments Authorities.

The SCT will grant concessions for a fee and for renewable periods up to a maximum of 50 years, for the construction, operation and exploitation of railways which are considered "general means of communication," and for the public railroad transport of cargo, passengers or both. A prior bidding process is necessary to obtain the concession.

The permits required to render the auxiliary services at passenger and cargo terminals, and for maintenance and supply of railroad equipment will only be granted to Mexican individuals or companies. However, such Mexican companies may have up to 100% foreign equity in their capital. If there is more than one party interested in rendering a specific service, the permit will be subject to prior bidding process.

Additional permits are required to construct crossings or accesses to marginal installations on the railways, to install publicity advertisements and to construct and operate railway bridges. Such permits will be granted under the same criteria as the permits above.

**8. Casinos, Gambling, Raffles, and Federal Law.** Gambling Business is regulated in Mexico under the current Federal Gambling and Raffles Law published on December 31, 1947. Under this Law, only the following activities are permitted if controlled by the State: (i) wagers on sports and (ii) lotteries and raffles.

However, the recently proposed Federal Casinos, Gambling and Raffles Law ("New Casinos Law"), if approved by the Mexican Congress, would allow the establishment of Casinos under certain circumstances and with certain restrictions.

It is in the Authorities utmost interest that the New Casinos Law is approved by Congress in order to avoid illegal casinos, corruption, and related activities. Additionally, Mexico would receive not only a considerable amount of direct and indirect foreign investment in the areas of construction, hotels, restaurants, etc., but also benefit from an increase in available jobs.
Approval of this New Casinos Law is expected soon because of the income and benefits stemming there from.

The New Casinos Law will regulate the (i) "Jai Alai" Games, (ii) Horse Races, (iii) Greyhound Races, (iv) Rooster Fights, (v) Roulette, (vi) Lottery, Bingo and Keno, (vii) Craps and Card Games, (viii) Wheel of Fortune, and (ix) Slot Machines. Items (v) to (ix) above will have to be carried out within an established Casino.

The Commission will grant the necessary License to open and operate a Casino, and to carry out Gambling and Raffles activities. The Commission will grant the corresponding License through a public bidding, and with the approval of the Governor of the corresponding State in the Mexican Republic where the Casino is to be located. The Licenses will only be granted to Mexican companies, however. The percentage of permitted foreign investment within such companies is not yet established. The term of the licenses will be for renewable periods of 20 years, provided the Licensees continue to comply with the Mexican Laws and request such renovation within a year of the termination of the License.

The Commission will have a Casinos and Gambling Registry in which the following must be registered: (i) Casinos, (ii) any License in such regard, (iii) Employees of the Casinos, (iv) Slot Machines, (v) assignments of any right, (vi) any transfer of shares higher than 10% of the Company’s equity, and (vii) The Internal Rules of each Casino.

A. Regulations of the Federal Gambling and Raffles Law. The Regulations to the Federal Law of Games and Drawings were published on September 17, 2004, and entered into effect one month later (20 working days thereafter).

a. Regulated Games and Drawings. The Regulations regulate the provisions of the Federal Games and Drawings Law that deal with authorization, control, oversight and inspection of games and drawings of all types, except those restricted to the National Public Lottery.

The Regulations allow the involvement of private entities in games and drawings including, among others: (i) direct or on-line betting; (ii) numeric games or contests of diverse nature including, without limitation, lottos, raffles, drawings, sweepstakes, pre-printed and instant tickets, contests involving the prediction of results in sports events (i.e., soccer, football, automobile and horse races or any other type of competition); (iii) sports books, sports bets, including the collection and verification of odds on bets regarding horse and greyhound races and other sporting events such as soccer matches, football, basketball and any other type of competitions or races; (iv) storage, distribution and sale of the tickets required to participate in instant contests; and (v) the installation, operation, maintenance and upgrading services of any equipment and software related to the foregoing.

All Games and drawings shall be made in Mexican currency.

No Slot Machines of any type shall be subject to authorization. However, the following devices are not considered slot machines and therefore are subject to the Regulations: betting terminals or machines for playing and betting on sporting or racing competitions; electronic drawing of numbers; and in general, those used to develop authorized Games and Drawings.

b. Authority to Regulate Games and Drawings. The Ministry of the Interior (“Secretaría de Gobernación”) ("The Ministry") shall be the government agency in charge of upholding the Regulations, through the General Adjunct Administration of Games and Drawings (“Dirección General Adjunta de Juegos y Sorteos”) (“The Administration”).

c. Permit Holders, Operators and Beneficiaries. The Ministry, through the Administration, shall review and grant the permits to allow an individual or entity (Permit Holders) to perform the drawings or games and activities described above, during a specific period of time, under the terms and conditions established by the Ministry, and in accordance with the Law and the Regulations and any other applicable provisions.
The Permit Holder is an individual or entity to whom the Ministry grants a permit to carry out activities related to games and drawings under the Law and its Regulations. The Permit Holder is only permitted to perform those activities.

Permit Holders may carry out the activities related to authorized games and drawings through Operators.

The Regulations also recognize and regulate the "Beneficiaries:" These are individuals who, without necessarily having the attributes of a shareholder or partner of a Permit Holder, receive through any means the proceeds from the exploitation of the Permit, and who finally exercise, directly or indirectly, control over the Permit Holder, and receive the benefits of the Permit.

d. Admission to Gambling and Drawing Establishments. The Regulations limit admission to previously authorized gambling and drawing establishments. The Regulations prohibit the following:

(i) Access to or presence of minors in the gambling areas of establishments, except for live shows when accompanied by an adult; however, in no case shall minors participate in the placing of bets;

(ii) Admission to persons in possession or under the influence of controlled or prohibited substances or under the influence of alcohol; those carrying fire arms; those whose conduct alters the peace and order of the establishment; those caught cheating;those who do not comply with the rules of the establishment as approved by the Ministry.

e. Credit to Gamblers is Prohibited. Permit Holders shall not grant credit, directly or indirectly, to the gamblers of betting games or to participants of drawings during the carrying out of permitted activities.

f. Non-Regulated Games and Drawings. The Regulations apply to commercial gambling and drawing and do not apply to sporadic not-for-profit games and drawings that take place in private homes for the purpose of occasional amusement or recreation, and provided that only persons who are related or have social or emotional relationships with the owners, possessors or residents of the place in which they take place, are admitted.

g. Publicity and Promotion. All publicity and promotion of games and drawings will be carried out in accordance with the Regulations, and may only be performed with the Ministry's previous authorization. The Regulations basically require that the promotion and publicity be clearly and accurately stated so that the public is not induced to error, deceit or confusion with respect to the services offered, and that it clearly limits the participation of minors.

h. The Counsel of Games and Drawings. The Regulations provide for a Counsel of Games and Drawings to act as the consulting body of the Ministry. This Board will recommend to the Administration measures and regulatory improvements for the operation and service innovation procedures in games and drawing establishments. It will issue opinions with respect to the issuance of permits regarding games and drawings.

i. Data Base on Games and Drawings. The Administration will integrate and update a data base on games and drawings, that will contain, at a minimum: (i) the permits granted and their modifications; (ii) the penalties imposed by the Ministry; (iii) the identity of permit holders and operators, and their last shareholders or beneficiaries; (iv) the identity of the officers and employees of first level of each permit holder, and its operator; (v) the identity of the professional service providers related to the brokerage and placing of bets in authorized establishments; (vi) the names and photographs of the inspectors of the Ministry and any sanctions that might have been imposed on them, as well as those who have retired; (vii) data and statistics on the national activity of games and drawings; (viii) quarterly and annual financial statements of the permit holders; (ix) procedures of administrative sanctions in process regarding any games or drawings, including those that are in court litigation, as well as any legal proceedings against the permit holder, its operators, shareholders or beneficiaries; (x)
resolutions issued by the Counsel; (xi) any other technical consulting entities created by the Ministry that consult with respect to horse race tracks, greyhound race tracks and jai-alai courts.

The information contained in the Data Base shall be updated and appear on the Ministry's website within ten working days of the previous update, in strict compliance with the provisions of the Federal Law of Transparency and Access to Public Governmental Information and its Regulations.

j. Permits for Games and Drawings. Permit Holders and Foreign Investment Participation:

(i) Permits for the opening and operation of bet placement at horse race tracks, greyhound race tracks, jai-alai ("frontones"), and the installation of centers of remote bets, and for rooms for numbers drawings, shall only be granted to companies incorporated in Mexico (may have "majority" foreign participation);

(ii) Permits for the opening and operation of bet placement at fairs shall only be granted to Mexican companies (may have "minority" foreign participation);

(iii) Permits for the opening and operation of bet placement at horse races in temporary settings and at rooster fights, shall only be granted to Mexican individuals and companies incorporated in Mexico (may have "majority" foreign participation); and,

(iv) Permits for the organization of Drawings, shall only be granted to Mexican individuals and companies incorporated in Mexico (may have "majority" foreign participation).

Foreign companies may be Operators.

To obtain a permit, the Applicant Permit Holder and, if applicable, its Operator, shall comply with the information required by the Regulations.

The Regulations basically require documentation to evidence existence, nationality, domicile, ID and tax ID, general background and information on its financial situation. Also required is an affidavit indicating that they have not been prosecuted nor convicted of any felony of patrimonial or fiscal nature, nor are related to organized crime. They also require the posting of a bond to guarantee the payment of prizes.

In addition, if the Applicant Permit Holder and its Operator are legal entities, they need to show evidence of their incorporation and registration in Mexico, and evidence of the powers of its agents. Also, evidence on the experience of the Permit Holder or its Operator must be shown.

The Applicant Permit Holder and its Operator, must provide information on their partners or shareholders, and the identity of their ultimate Beneficiaries.

They must also show information on their directors, auditing examiners and high level officers.

They must also show information on their general balance, audited financial statements, and capital variations for the last five years

They must provide a study that justifies the geographic location and financial feasibility of the establishment where the games and drawings shall be installed. The study shall be performed during the first ten years of operation and shall justify the financial projections and the generated employment numbers for each period.
They must provide the intended location for the establishment and compliance with zoning regulations.

They must provide the general operation program, internal regulations and the organization manual of the establishment.

The Regulations provide for a substantial amount of reporting from the Permit Holder and its Operator, as the case may be. If the Permit Holder and its Operator are non-public companies, they should provide information of any change in capital.

Permits are non-transferrable and may not be subject to any encumbrance, assignment, sale or commercialization.

k. Permit Terms. The terms of permits granted by the Ministry vary as follows:

(i) Permits for the opening and operation of bet placement at horse race tracks, greyhound race tracks, jai-alai courts, centers for remote bets and rooms for numbers drawings will have a maximum term of 25 years. These permits may be extended for subsequent periods of up to 15 years, provided that the Permit Holders are in compliance of the Regulations;

(ii) Permits for the opening and operation of bet placement at regional fairs, cockfights and horse races in temporary settings, shall have a maximum term of 28 days or equivalent to the duration of the authorized season;

(iii) Permits for the operation of Drawings in trade systems, shall have a term equal to the period of time sufficient to guarantee the corresponding award of the goods and the rendering of the corresponding service; and

(iv) Permits for the operation of Drawings with sale of tickets, Drawings without sale of tickets and instantaneous Drawings, will have a maximum term of one year.

The individuals who are organizers or employees of the Permit Holders, or are involved in the production of tickets or in the drawings in which the prizes are determined, shall not participate in such drawings.

The Regulations provide for a number of requirements for those individuals actually involved in the services connected with games and drawings at the authorized establishments.

The Regulations provide for detailed rules on the establishment of (i) horse and greyhound race tracks, and (ii) Jai-Alai courts ("Frontones"). Also there are detailed provisions on games and drawings at fairs (temporary regional events), and at temporary horse races and cockfights.

The Regulations provide for detailed rules on the establishment of remote betting, known as books, to operate bet placement in sporting competitions performed abroad or on Mexican territory, broadcasted in real time and in a simultaneous manner in video and audio, as well as for the practice of numbers drawings as indicated.

l. Rules on Drawings. The Regulations provide for detailed rules on Drawings.

The Regulations discuss their different forms: (i) with sale of tickets; (ii) without sale of tickets; (iii) instantaneous drawings; (iv) by different trading systems; (v) with symbols or numbers; and (vi) broadcasted by means of mass communication.
The Regulations also detail how the prize may be obtained through different mechanisms such as: (i) by "tombola" [revolving drum]; (ii) by number formations; (iii) by number termination in relation to the drawing of the National Lottery; or (iv) through software systems that determine the numbers with prizes at random.

Drawings where the consumption of the following is promoted shall not be authorized: tobacco; alcoholic beverages; prescription drugs; or products or goods as provided for in the General Health Law that do not promote good health.

In all drawings an Inspector appointed by the Ministry will be present to certify the performance of the event. In lieu of the inspector and due to force majeure a notary public shall be accepted.

The Regulations also provide for inspectors who will oversee the compliance with the provisions of the Law and Regulations.

m. Administrative Penalties. Finally, the Regulations provide for administrative penalties encompassing fines to arrest, suspension or revocation of permits, and the closing of the establishments.

9. Insurance. The insurance industry is federally regulated and closely overseen by several law and government entities (the Ministry of Treasury and Public Credit, Insurance Law, and the National Insurance and Bonding Commission, among others).

Because of the highly regulated nature of insurance in Mexico, it may be most advantageous to establish a subsidiary in Mexico. It allows the foreign entity the most flexibility to participate fully in the Mexican market, without limitations, yet be in full compliance with Mexican law. Per NAFTA Annex VII, Part B, §7, as of January 1, 2000, the percentage requirement of Mexican ownership was lifted. Therefore, a Mexican insurance company may have 100% foreign capital.

A subsidiary to a foreign insurance company is, in reality, a Mexican corporation authorized to incorporate and function pursuant to all insurance laws and regulations, as an insurance institution, and in which the capital stock participation will be in majority, or in totality, owned by a foreign insurance entity that operates in the United States of America or Canada. The application process for authorization to function as a Subsidiary lasts approximately six months, and is to be done in accordance to NAFTA’s Chapter XIV Financial Services guidelines, Chapter I Bis Affiliates to Foreign Financial Institutions of the Insurance Law, and any other applicable regulation.

The benefit to establishing the business in this manner, is that according to Mexican Law, Subsidiaries may do business as any other registered and approved national Insurance Institution (Insurance Law, Art. 33-D of Chapter I Bis). Therefore, the “special” restrictions and prohibitions to foreign entities establishing/operating a Representative Office (see above, III. Doing Business with Mexico: 9C Representative Offices-Promoting Insurance), no longer apply. The business must simply conform to the national rules and regulations overseeing the Insurance sector.

Note: per Mexican Income Tax Law, any income received from "offshore financial institutions" located in Tax Paradises or Tax Havens (i.e. Bermuda), is taxed at the highest applicable rate of 30% (to be reduced by 1% each year until reaching a maximum of 28% in 2007). On the other hand, Art. 109 of the Mexican Income Tax Law exempts income received from life insurance in Mexico. The possibility that the insurance income from offshore companies will be taxed at such a high rate, should be clearly and carefully disclosed and explained to any Mexican citizen clients.

10. Stock Brokerage Houses. A foreign entity may open a subsidiary in Mexico, and operate as a national brokerage house or investment company, when there exists an international treaty between the two countries allowing such establishment and operation. U.S., Canada, and Mexico investment firms have NAFTA as the treaty where subsidiaries are allowed in another Party’s territory. Despite the regulated environment in Mexico, this allows the foreign entity to participate fully in the Mexican market without the restrictions of functioning, for example, as a Representative Office. The
principal legislation regulating such operation is the Mexican Stock Market Law (Ley de Mercado de Valores, Capítulo III Bis).

The establishment and operation of a Subsidiary must be authorized by the Ministry of Treasury and Public Credit, in consultation with the National Banking and Securities Commission (Comisión Nacional Bancaria y de Valores). The foreign entity must be registered and certified to operate in its home territory, as it will be operating in Mexico. In order to qualify as a Subsidiary, 51% or more of the capital must derive directly or indirectly from a foreign entity. These shares (Class "F") are transferable only with prior authorization from the Ministry. A majority of the members of the Board of Directors must be residents of Mexico. Note: such Mexican Subsidiary may not establish its own subsidiary outside of Mexican territory.

If, however, the foreign entity wishes to have a non-income yielding introduction to the Mexican market, it is advisable to establish a representative office, instead. For an in-depth discussion of this topic, see above (III. Doing Business with Mexico: 9E. Representative Offices: Securities Promotion).

VI. NON-CITIZEN REAL ESTATE PROPERTY RIGHTS IN MEXICO.

Per the Foreign Investment Law Title II, Ch. I, Article 10, Mexican companies with foreigners' exclusion clauses, or Mexican companies that have entered into an agreement with the Ministry of Foreign Affairs by which their foreign owners will consider themselves Mexican nationals with regard to their investments, and agree to pursue all legal claims in Mexican courts rather than seek the protection of their home government or international tribunals (per Section I, Article 27 of the Mexican Constitution), may acquire ownership in real estate within the National Territory.

Regarding acquisitions in the Restricted Zone, the rules below will apply:

1. Acquisition in the Restricted Zone. Companies whose by-laws include the agreement provided for in Section I of Article 27 of the Mexican Constitution, may:

   A. Acquire title of real estate located in the strip of Mexican territory of 100 kilometers wide along the borders and 50 kilometers wide along the coastlines (the "Restricted Zone"), if it is destined for the performance of non-residential activities, and such acquisition is registered with the Ministry of Foreign Affairs; and

   B. Acquire rights in relation to real estate in the Restricted Zone if such real estate is destined for residential usage, if the following rules are observed:

      a. A trust is created with the prior approval of the Ministry of Foreign Affairs. In this trust a credit institution will acquire the real estate as trustee, the trust is for the purpose of using and exploiting such real estate, and the trust beneficiary is a Mexican company without a foreign exclusion clause, or a foreign individual or legal entity.

      b. The duration of these trusts shall be for a maximum period of 50 years, which can be extended upon request.

VII. FOREIGN TRADE LAW.

The purpose Foreign Trade Law is to promote the competitiveness of the Country through norms, principles and institutions that will respond to both normal and emergency situations of Foreign Trade.

   A. Federal Executive. The Federal Executive will have the power to create, modify or eliminate tariffs as well as to restrict the export or import and movement of products by means of emergency measures published in the Official Federal Gazette.

   B. The Ministry of Economy. The Ministry of Economy will study, draft and determine changes in the regulations to the export or import and movement of products, as well as negotiate and resolve administrative procedures of unlawful practices of international commerce and impose compensatory quotas and other regulations to foreign trade.

   C. Auxiliary Commissions. The Foreign Trade Commission will function as an obligatory consulting organ of the agencies and entities of the Federal Government and will issue opinions, make revisions, and can have public hearings on matters of foreign trade.

2. Determination of the Origin of Goods. The determination of the Origin of the Goods is necessary in order to determine the tariff preferences, country of origin marks and compensatory quotas of the goods in question. These determinations, in turn, are considered when establishing changes of tariff classification, national or regional content, and the process of production.

   The origin of the goods will be determined in accordance with the rules established by the Ministry of Economy or by international agreements to which Mexico is a party (i.e. NAFTA) and shall be previously submitted for the opinion of the Commission and published in the Official Federal Gazette. The origin of the goods will be deemed "national" if only one country is involved in the production of such goods, and will be "regional" if more than one country is involved in their production.

3. Labeling Standards. The Ministry of Economy issued enforcement guidelines to comply with the new labeling standards for consumer goods, prepackaged food and non-alcoholic beverages. Importers have the option to comply with the standards prior to or at the time of importation into Mexico.

   If the importer chooses to label its product in Mexico, the importer must ship it to a General Deposit Warehouse, authorized as a verification unit, within 20 days of activating the aleatory selection mechanism at the border. The actual Labeling must take place at the Verification Unit where officials will verify and enforce compliance with the appropriate Official Mexican Norm ("NOM") and release the complying merchandise. The importer must declare in its "pedimento" that it has chosen this option by including the code provided by Customs to identify that the products are being subjected to it. A written, sworn statement must also be attached indicating the name, authorization number and the address of the Warehouse where the products are to be labeled. The importer must comply with the given NOM at the Warehouse, and must not commit acts which are sanctionable in Mexico after importation.

   NOMs vary according to different products and should be consulted accordingly prior to the introduction of such products into Mexico. Care should be taken to follow the NOMs to avoid delays and/or fines for non-compliance.

4. Tariff Regulations and Characteristics. The Law establishes the types of tariffs to be levied on the goods such as: Ad Valorem, Specific, and Mixed. The characteristics of the tariffs are Tariff-Quota, Fixed-Tariffs and others as indicated by the Federal Executive.

5. Non-Tariff Regulations and Restrictions. The Law specifies the cases in which the Ministry can establish, with the prior consultation with and opinion of the Commission of Foreign Trade, Non-Tariff regulations and restrictions to the exportation of goods. These regulations and restrictions include licenses, quotas, and country of origin marks in connection with the exporting and importing of goods. In all cases, the importing of products will remain subject to the NOMs.

A. Unlawful Practices. The Law defines unlawful practices as the importing of goods with discriminatory prices or subject to subsidies in the country of origin or point of departure, that cause or threaten to cause an injury to national production. If unlawful practices are determined, the goods may be subject to compensatory quotas, regulations and restrictions, or safeguard measures.

   a. Discriminatory Prices. The importing of goods with discriminatory prices is defined as the introduction of goods into the national territory at a price less than normal market value. The normal market value of the exported goods to Mexico is the price comparable to the identical or similar goods that are destined to the internal market of the country of origin in the course of normal commercial operations.

   b. Subsidies. The Ministry of Economy will consider that a foreign government has given a subsidy when such government gives to any public or private entity engaged in commerce a benefit or benefits that give such entity an unfair international competitive advantage, unless it is internationally accepted practice.

B. Compensatory Quotas. Compensatory quotas are imposed to discourage importing through unlawful practices. In the event that the Ministry confirms that a provisional compensatory quota is warranted, the payment of such quota or authorized guarantees must be paid by the individuals or legal entities that imported the goods through the unlawful practice.

   a. Annual Revision of Compensatory Quotas. Definitive compensatory quotas that have been imposed to stop the threat of injury caused by discrimination of import prices or subsidies may be revised annually by petition of the interested party and may be revised at any moment by the Ministry of Economy. These revisions shall be published in the Official Federal Gazette and communicated to the interested parties.

   b. Promises by the Exporter and Governments. The interested parties may participate in the revision procedures. In order to prevent the compensatory quotas, the exporter may voluntarily promise to modify his prices or cease his exports, or the government of the exporting country can eliminate or limit the subsidy.

C. Safeguard Measures. Safeguard Measures temporarily regulate or restrict the importing of identical or similar goods which directly compete with the products produced nationally, with the purpose to prevent or remedy a serious economic injury caused to national producers.

7. Administrative Procedures. The Ministry of Economy will have 30 days starting from the presentation of the request to initiate the investigation for the determination of unlawful practices and compensatory quotas. The requesting party will have 20 days from the receipt of the notification to deliver the data or documents that the Ministry requests. The Ministry will then have an additional 130 days to issue a preliminary resolution, before the provisional resolution is determined, which shall be communicated to the interested parties and published in the Official Federal Gazette. The Ministry will then have another 130 days to dictate the final resolution, before the definitive resolution is determined, which in turn shall be communicated to the interested parties and also published.

A. Petitions. Once the definitive compensatory quota is established, the interested parties can request the Ministry of Economy to determine if the goods in question are subject to it. In the event that the goods are subject to the quota, the Ministry shall allow the other interested parties to participate in the proceedings and should answer the petitioning party in accordance with the procedures established in the Rules which will have the character of a final resolution. The resolution shall be communicated to the interested parties and published in the Official Federal Gazette.

B. Conciliatory Hearings. The Law prevents the imposition of compensatory quotas and safeguard measures without first having heard from the interested parties. Foreign exporters and foreign entities may also be considered interested parties.
C. Infractions and Administrative Sanctions. Sanctions are imposed if a party falsifies, omits, fraudulently alters or is grossly negligent in providing data or documents, or if, among others, he divulges and utilizes confidential information. Violation of these provisions may result in sanctions, ranging from the value of the imported goods to 180 times the present minimum salary in the Federal District.

VIII. CONCLUSION.

Mexico has made a considerable effort in recent years to encourage and attract investment and trade. During the last 10 years, NAFTA has accelerated the process of "opening" Mexico even further to the entry of foreign businesses, capital, goods and services, and persons into its economy.

Today's worldwide economy is presenting competition challenges in all countries and in all business areas.

Better management systems and aggressive leadership have caused newly created companies to grow and challenge the market shares of the most established companies, in a matter of months, any where in the World.

Fast communications by all means, through air, water, roads, rail, telephone, and by electronic means, have expanded the ability of entrepreneurs to reach across countries, and advertise and sell their products and services with amazing facility.

China's newly gained popularity among world manufacturers, is affecting traditional manufacturing countries such as Mexico, and other industrialized nations.

Mexico is perhaps the Country with most Commercial Treaties, and this has represented a historic opportunity to further strengthen Mexico’s economic and cultural ties with the United States, Canada, South America, Europe and the rest of the World.

This is the era of knowledge and information, and the best business decisions are made through previous fact finding and good information.

Again, as mentioned in the Preface, the purpose of this Guide is to provide initial information and a solid road map to international companies and entrepreneurs that find investing and risking in Mexico a way to compete and expand their business market. We hope that through this Guide we have contributed, at an initial stage, to such a purpose.

"I do not go to see if I can but, because 'I can,' I go for it, ...and for that I have prepared."
From: Carlos Santistevan E. (1912-1992)
### ABBREVIATIONS AND ACRONYMS

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