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Editor
Mark Zerdin

THE LAWREVIEWS

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TWELFTH EDITION

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PREFACE

Despite a slight decrease in overall activity compared with 2016, 2017 was a strong year for global M&A activity as, for the fourth consecutive year, global deal-making activity exceeded US\$3 trillion with announced transaction volumes reaching US\$3.7 trillion. Even though 2017 did not replicate the record-breaking number of mega-deals in 2015 nor the high volume seen in 2016, market participants in a number of sectors took advantage of continued access to cheap capital globally to engage in M&A activity.

The United States remained the most active region, although aggregate deal value decreased by 16 per cent year on year. However, deal volume surged with a record 12,400 individual deals, largely due to an increase in transactions with a value of less than US\$1 billion. The relative decline in mega-deals in 2017 is largely attributable to continued regulatory uncertainty, particularly in the United States, where President Donald Trump's electoral rhetoric on antitrust has led to an increase in scrutiny for M&A deals. In Europe, however, continuing uncertainty arising out of the stuttering progress in the Brexit negotiations and a number of significant elections within the European Union did little to halt the momentum of the M&A market as aggregate deal value in Europe increased by 12.1 per cent in 2017 to reach a post-financial crisis high of more than €830 billion. Notably, the industrials and chemicals M&A sector flourished, with record high aggregate deal value and deal volume. Chinese outbound M&A was limited during 2017 by both a new capital-controls regime and increased scrutiny from the US and European governments.

On the back of tax reform in the United States and encouraging economic growth in Europe, the first quarter of 2018 has displayed record-breaking deal-making activity. However, global political uncertainty presents a threat to global M&A in 2018. Although there were positive signs from the European M&A market in 2017 and Europe registered the largest year-on-year increase in deal volume in the first quarter of 2018, the rise of anti-EU populist parties threatens to derail the buoyant global M&A market. Notably, the election of an anti-EU populist government in Italy, formed from a coalition of the Five Star Movement and the League, threatens to unnerve foreign investors and increase uncertainty about the integrity of the eurozone.

In addition, President Trump's imposition of tariffs and protectionist instincts have raised concerns about the possibility of a global trade war. It is hoped that a resolution to Brexit-related uncertainty and a settling of trade worries will foster an environment in which markets can thrive. All that being said, markets have shown during the past two years that despite an ever-evolving geopolitical landscape, there are numerous opportunities for those market participants who are keen to pursue them.

I would like to thank the contributors for their support in producing the 12th edition of *The Mergers & Acquisitions Review*. I hope the commentary in the following 50 chapters will provide a richer understanding of the shape of the global markets, and the challenges and opportunities facing market participants.

Mark Zerdin

Slaughter and May, London

July 2018

MEXICO

Eduardo González, Jorge Montaña and Humberto Botti¹

I OVERVIEW OF M&A ACTIVITY

The Mexican M&A market continued to show stable performance throughout 2017 and the first quarter of 2018, even amid countless challenges posed by the uncertainty of the political and trade environment with the Trump administration and the Mexican presidential election to be held in July 2018. In particular, the progress (or lack of) in the North American Free Trade Agreement negotiations has constantly resulted in volatility on the peso-dollar exchange rate. Certain assets have become difficult to price, and therefore some transactions have been temporarily put on hold; however, other participants in the market continue to push forwards with their transactions ahead of the election, in some cases as a defensive measure.

Macroeconomic fundamentals remain strong and, coupled with a weakened peso, continue to provide attractive investment return opportunities in several industries, including financial services, insurance, real estate, consumer products, health, manufacturing and industrial.

According to Transactional Track Record, a reported 75 transactions were completed or announced during the first quarter of 2018, totalling a reported value of around US\$6 billion. The number of transactions has increased year-on-year when compared to the first quarter for 2016. The busiest sectors were financial services and insurance, with a reported 17 transactions, followed by real estate, technology and oil and gas with nine, seven and seven reported transactions respectively. The private equity industry continues to be a key driver for M&A activity in Mexico, led by several established international and local firms as well as, most recently, family offices. Recent trends also provide evidence that the venture capital industry is beginning to show signs of growth and development. Another sign of this positive and optimistic trend is the arrival of several M&A advisers, including Lazard, Moelis and Alantra.

On the public exit front, although the initial public offerings market has historically lagged behind other emerging financial markets, there is optimism that increasing exit opportunities through the public offering of securities will be available to investors in the near future as the Mexican Pension Fund investment regimes continue to become more sophisticated and diverse, thus freeing up capital to be allocated to public offerings. Further adding to the mood of optimism is the recent government authorisation of a new stock exchange in Mexico known as BIVA.²

1 Eduardo González, Jorge Montaña and Humberto Botti are partners at Creel, García-Cuellar, Aiza y Enríquez, SC.

2 See www.biva.mx.

II GENERAL INTRODUCTION TO THE LEGAL FRAMEWORK FOR M&A

As may be the case for most legal markets, any M&A transaction in Mexico will probably be subject to several statutes depending on the target's activities and the industry in which the target operates. For example, during the due diligence investigation of the target or during the structuring of the transaction, laws ranging from the broad mercantile, labour and employment, tax, environmental, insurance and anticorruption statutes, to the more industry specific ones such as those regulating, *inter alia*, financial services, telecommunications, oil and gas, transportation and healthcare, will all provide guidelines and parameters within which all M&A transactions have to be structured.

In an effort to increase Mexico's attractiveness for investors, the federal government has steadily and successfully consummated several changes to statutes that were perceived to be outdated during the past few years. Certain commercial statutes (e.g., the Mexican Commercial Companies Statute and the Mexican Securities Market Statute) have been amended to incentivise M&A activity by allowing parties to, *inter alia*, freely agree on customary governance and liquidity provisions required for investors (particularly of an institutional nature) to attain a higher level of certainty on governance and exit provisions. Another key development has been the liberalisation effort led by President Peña Nieto's administration, through which the Mexican Foreign Investment Law has been subject to several amendments to decrease (or remove) foreign investment restrictions in, *inter alia*, the telecommunications and oil and gas industries.

The telecommunications industry's regulatory overhaul not only included the lifting of the foreign investment restriction,³ but also the creation of the Federal Telecommunications Institute, which is now a much more specialised regulatory governing body with broader authority to regulate the market (particularly from a market competition perspective). It is also the entity in charge of evaluating every transaction within the telecommunications industry subject to antitrust approval (separate from the Mexican Federal Competition Commission). The Federal Telecommunications Institute declared both Televisa and America Móvil preponderant agents,⁴ resulting in them being subject to several asymmetric provisions (e.g., mandatory interconnection, maximum interconnection rates, asset divestitures and changes in governance). These asymmetric provisions (particularly with respect to America Móvil in the mobile telephone sector) have resulted in a much more competitive market, and in lower costs and improved services for end users.⁵ In an effort to capitalise on these amendments and seek to compete with America Móvil, AT&T acquired two of the largest carriers operating in Mexico.

Similarly, in a highly anticipated development in the energy and hydrocarbons sector, the Mexican Constitution was amended to allow private foreign investment in extraction and production (E&P) projects to incentivise and grow Mexico's refining, natural gas processing, industrial transformation, transportation, distribution, storage and retail of liquid fuels, natural gas and petrochemicals industries, thus ending the historical state monopoly in the oil, gas and petrochemical sectors. Among the regulatory changes, Pemex (Petróleos

3 Foreign investors can now acquire up to 100 per cent of targets.

4 Defined as any agent that holds more than a 50 per cent national market share, whether measured by users, audience, band capacity or traffic.

5 At the time of writing, there is ongoing litigation in respect of the imposition of asymmetric provisions.

Mexicanos) was transformed into a state productive company⁶ to compete efficiently in the oil and gas market by, *inter alia*, enjoying budgetary autonomy (subject to several limitations and congressional oversight) and a specific public procurement and public debt regime. The National Hydrocarbons Commission was restructured to become the decentralised entity of the Ministry of Energy responsible for procurement, bids, subscription and technical administration of awarded oil and gas E&P contracts. According to the Ministry of Energy, these developments are expected to result in investments of more than US\$20 billion and have already triggered M&A activity for this sector (and for all ancillary servicing and supply industries).

Although the oil and gas sector reform drew most of the headlines resulting from the energy reform, the electricity sector reform has proven to be just as vital. It allows open competition from private and public entities in the generation and commercialisation of power, including in renewable sectors such as solar, wind and geothermal. Mexico's Federal Electricity Commission (CFE) (directly or indirectly through its newly created operating subsidiaries) handles the transmission, distribution, construction and maintenance of the grid; however, CFE may outsource these activities to private investors. Given the high amount of capital needed to implement these projects, many sponsors will seek to raise capital, which could result in a spark in the M&A and financing sectors in Mexico and all other cross-border jurisdictions with allocable capital. Just one example of M&A activity in this sector during 2017 was the acquisition by Actis of InterGen Mexico, which is one of the largest combined-cycle gas turbine operators in the country. Furthermore, the renewables sector has begun to see activity in wind and solar projects, with players such as Goldman Sachs Infrastructure Partners, GBM Infraestructura, Thermion Energy, GEMEX, Enel Green Power and CDPQ being involved in several transactions.

III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT

While the statutes relating to corporate and takeover law have remained relatively untouched, changes in respect of certain capital market products are sure to have a significant effect on the M&A landscape in Mexico.

By way of background, the Mexican pension funds (AFORES) are still restricted in the investments that they are allowed to undertake in accordance with their investment regime, which is set forth by law. AFORES are not permitted to invest directly in privately held companies, but they are allowed to invest in publicly listed companies and other publicly listed investment vehicles. This spurred the creation of publicly traded vehicles that are managed by a general partner and that serve as platforms to carry out investments in various sectors (CKDs), including the private equity, infrastructure, renewable energy and real estate sector. The existence of the CKD market in Mexico has caused M&A transactions in various fields and sectors to take off, as pension funds put their cash to work, through fund managers, in acquisitions and similar investments.

There are four similar products that are worth discussing, that complement the CKD market in Mexico. The first is the creation of real estate investment trusts (FIBRAs), a vehicle that invests in or acquires a real estate asset portfolio and is created through the issuance of a

⁶ The transformation intends to allow Pemex to operate more as a privately owned enterprise to seek profitability improvements.

public offering and ultimately listed in the Mexican Stock Exchange. The Mexican real estate market has historically been quite active. However, since the creation of FIBRAs, M&A activity in the real estate sector has increased significantly given that the creation of a FIBRA typically entails the bundling or acquisition of real estate assets that will become part of the FIBRA. The sponsors that manage FIBRAs have additional firepower from the amounts raised in the public offering or in follow-on offerings to acquire additional assets for the FIBRA's portfolio, and FIBRAs present a great take-out opportunity for real estate developers and other stakeholders of real estate properties.

The second product created the equivalent of a master limited partnership, the FIBRA E, which is an investment vehicle for energy and infrastructure projects and is listed on the Mexican Stock Exchange. One key feature is the tax benefits provided to investors in a FIBRA E, as the investment vehicle and the portfolio companies through which investments are held in the infrastructure and energy assets are deemed transparent from a tax perspective. There is a robust pipeline of FIBRA E projects for the future. While a strong impact on M&A activity is not evident yet, given that it is relatively a new product, there is an expectation that transactions in the energy and infrastructure space will continue to increase.

The third product is the special purpose acquisition company, or SPAC, which is an investment vehicle listed on the Mexican Stock Exchange that obtains funds from the public offering through which it is created to invest and acquire a company, which may or may not be identified at the time of the public offering. Essentially, it provides a sponsor with sufficient funds to conduct an M&A transaction within the 24 months following its creation. The first of its kind, Vista Oil and Gas, was successfully launched in August 2017, raising US\$650 million in the public offering. This first offering seems to indicate a significant acceptance of these types of investment vehicles in the Mexican market, but only time will tell if that acceptance continues and what effect they will have on the M&A market in Mexico.

The fourth product is the CERPI, which is a derivative of the CKD, but with two key differences: the first is a management and governance structure that more closely resembles a traditional private equity fund, in which limited partners are expected to have a very limited role in management and governance; the second, and the one that has really triggered a spur in the use of this product, is that up to 90 per cent of the proceeds raised in a CERPI may be deployed outside Mexico. This has led many international fund managers to seek to fundraise in Mexico, as they can use it now as a regional platform to invest, not only in Mexico but outside of Mexico as well. This development is certainly expected to raise the level of M&A activity as these funds begin to deploy the funds they raise.

IV FOREIGN INVOLVEMENT IN M&A TRANSACTIONS

As noted in previous sections, the participation of international and global companies in the Mexican market continues to be attractive. The level of cross-border transactions continues to be significant; the country's economic fundamentals are stable and reflect a solid economy.

It is important to note that the United States continues to be the country that represents the most foreign investment activity in Mexico. Other principal countries carrying out substantial direct foreign investment in Mexico are Spain, Germany and Canada.

Given the manufacturing capabilities that Mexico has developed, the steadily growing middle class and increase in consumerism, certain sectors continue to be ripe for foreign investment, as has been evidenced through recent M&A transactions, and these are expected to continue to experience consolidation or otherwise attract foreign investment.

As can be seen from the examples in Section V and the trends that can be observed, we expect foreign investment to continue to drive a significant portion of the large and complex M&A transactions in Mexico.

V SIGNIFICANT TRANSACTIONS, KEY TRENDS AND HOT INDUSTRIES

As noted in the Section I, Mexican M&A performed strongly throughout 2016 and 2017. There is a trend of consolidation and a high volume of activity in certain sectors, such as the pharmaceutical industry, real estate, food and beverage, distribution and retail.

M&A activity in the real estate sector is driven in large part by FIBRAs, as discussed in Section III. Transactions mainly involve the acquisition of real estate portfolios, such as the acquisition of the MRP portfolio by Fibra Uno a few years ago, which at the time was one of the largest M&A transactions in the sector in Mexico's history. The acquisition story driven by FIBRAs has not slowed since then.

The infrastructure (such as toll roads) and 'soft' infrastructure (such as government-concessioned hospitals, schools and prisons) space continues to attract international institutional investors, such as the Canadian pension funds.

The pharmaceutical industry remains fragmented and filled with attractive targets.

In the aerospace and automotive sectors, we continue to see significant M&A activity although mostly on the basis of cross-border transactions effected by global players, but in respect of which the Mexican operations will still have a significant role.

The airline industry has also supported developments that have led and may continue to lead to M&A activity. Recent amendments allowing a greater participation (up to 49 per cent) of foreign investment led Delta Airlines to acquire a substantial additional stake in Aeromexico.

Finally, there has also been a trend for a higher volume of small transactions in the venture capital space, which may not represent significant M&A volume at this stage but should have an impact in the medium to long term as these ventures mature and investors need to effect exit transactions from their investments.

VI FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS

Mexican corporate law does not impose restrictions on financial assistance and thus a Mexican target company's ability to secure acquisition financing with its own assets makes financing alternatives relatively more available for M&A and private equity transactions. Mexican banks are actively participating in the market, and it has opened the door to other types of lenders, such as credit opportunities funds created by global institutions (e.g., Credit Suisse).

There is not any particular trend regarding bank and mezzanine debt on Mexican M&A and private equity transactions. As in other markets, a decision about the type of acquisition financing is based upon several factors, including the target company's sector and its growth plans and needs.

In those M&A and private equity transactions that include bank debt, Mexican banks are normally pressed to incorporate US terms in their loan documents, including material adverse change (MAC) provisions that match the acquirer's right to withdraw from the potential acquisition and provisions that seek to limit the conditions to the financing as regards the conditions applicable to the closing of the acquisition. Owing to the absence of financial assistance restrictions and a conservative approach to lending, Mexican banks very

rarely accept 'covenant-lite' loans, which thus turns the negotiation of the financing terms and conditions and the implementation of the relevant collateral packages into a substantial part of the legal work relating to the closing of a transaction.

When an M&A or private equity transaction involves financing, including a going-private transaction, one of the most controversial sections of loan documents is the one relating to the conditions for a drawdown, and specifically the material adverse effect (MAE) or MAC condition that directly affects the certainty of funds. It is hardly ever the case that the definition of a MAE or MAC in a purchase agreement matches the definition in the loan documents, and therefore the 'gap' is generally a risk that the acquirer or investor is asked to assume. In the context of a cross-border deal, the definition of a MAE or MAC becomes even more complex when negotiating political or national risk language within the agreement. Having said that, we see that sponsors in private equity transactions are generally more comfortable with the legal and related risks involved. Increasingly, investors focus more on returns and less on country risk.

With respect to leveraged buyouts (LBOs), the main consideration in structuring such transactions depends on the ability of target companies to pay dividends and make distributions to their shareholders regularly to service acquisition loans. Hence, when structuring LBOs in Mexico, it is paramount to incur the acquisition financing at the level of the operating target companies, or to somehow restructure the debt after the closing so that the operating entities can actually service the debt without having to deal with the tax and other timing restrictions applicable to dividends under Mexican law. In addition, in pricing acquisition financing, investors have to consider both the applicable withholding taxes on interest payments made to foreign lenders (and the potential incremental cost they represent in terms of gross-up provisions) and fraudulent conveyance issues under the Mexican Insolvency Law that are mitigated through due diligence, representations, warranties and, ultimately, indemnities.

VII EMPLOYMENT LAW

Employee subcontracting regimes are common in Mexico and, consequent to relatively recent amendments to tax and employment laws, a thorough diligence is crucial for identifying existing liabilities to avoid or reduce any labour or tax contingencies.

A subcontracting regime exists whenever employees of an entity (i.e., contractor) perform tasks or provide services to another entity (i.e., client). In view of the foregoing, whenever there is a subcontracting regime in place, it is crucial to verify whether it complies with the following conditions set forth by the Mexican Federal Labour Law:

- a* it cannot cover all the activities or those activities, similar or alike as a whole, that are performed at the workplace;
- b* services to be rendered must be justified because of their specialised nature; and
- c* subcontracting may not involve similar or the same activities as those performed by the other employees in the contracting party.

Failure to comply with the specific conditions will not only result in joint and several liability between the contractor and the client, but also in the direct obligation for the client to be liable for the costs of employment and social security obligations, including profit sharing.

VIII TAX LAW

New transfer pricing reporting obligations contained in Mexican law have an impact on tax filings for pre-closing, post-closing and straddle periods, as the buyer and seller will have to agree on the terms and conditions under which these obligations will be complied with on behalf of the target. Compliance with these obligations is particularly sensitive as it provides information related to the organisation and operation of the group worldwide, which, needless to say, the seller will not be willing to share with the buyer; thus, strong confidentiality provisions would have to be negotiated as well.

The imminent approval by Mexico of the OECD's Multilateral Instrument will limit access to certain tax treaties to which Mexico is a party. This is particularly important in light of the structuring work that needs to be performed prior to any M&A transaction taking place, because any structuring analysis will need to address additional limitations.

There are also new obligations within Mexican legislation related to the issuance of digital invoices, which are now applicable for, *inter alia*, stock purchases and payments made to non-Mexican residents. Starting in 2014, but increasingly ever since, the tax authorities have enhanced all the regulations pertaining to the issuance of digital invoices, which now apply to certain transactions that were not considered to be affected in the past. Accordingly, stock purchase agreements have to provide some detail in this regard to define which tax documents will be issued by whom at closing, thus avoiding any discussions, as these rules are numerous and detailed.

IX COMPETITION LAW

Enforcement by Mexico's antitrust agency has been particularly active during the past couple of years. Several ongoing investigations and the imposition of substantial fines in many sectors of the economy indicate the agency's new more aggressive stance. On the antitrust clearance front, while the outcome of many M&A transactions can be predicted, there are also borderline cases, in which pre-emptive planning for an intelligent approach with the agencies has become more important. Similarly, pre-closing integration efforts now need to be conducted with more sensitivity to antitrust requirements.

X OUTLOOK

Andrés Manuel López Obrador (AMLO), the presidential candidate for the coalition, Juntos Haremos Historia (JHH) – comprising left-leaning parties Morena and Partido del Trabajo and the right-wing Partido Encuentro Social – won by a landslide with 53 per cent of the popular vote shortly before this publication went to press. JHH also won a majority of both the Federal Chamber of Deputies and the Senate, which translates on JHH's ability to approve new legislation with its majority vote in Congress (including the federal budget), but will not have the percentage of votes to approve constitutional amendments alone.

Although AMLO continuously attacked the Energy Reform enacted by Peña Nieto's administration during the presidential campaign (see Section II), a closer read of the published campaign documents containing AMLO's proposals for public policies in the energy sector does not indicate a major shift in the regulatory framework that would affect the existing projects in the oil, gas and power industries. Essentially, the energy policy proposals are aimed at reducing Mexico's dependency on other countries to satisfy energy needs and achieve self-sufficiency. While implementing the proposals would result in a substantial

policy change by having a more actively engaged federal administration in guiding the oil and power sectors, all of them seem consistent with the legal framework set out in the Energy Reform enacted during 2013 and 2014.

AMLO expressed interest in reviewing Mexico's pension system, which is based on the mandatory contributions system managed by the AFORES (see Section III). AFORES' assets under management represent more than 14 per cent of Mexico's gross domestic product and they are Mexico's principal institutional investor, anchoring initial public offerings, public offerings and local funds. AMLO's National Plan specifically refers to the local capital market as a key source of financing for development and growth of strategic sectors such as oil, gas, power, housing, technology, and small and medium-sized enterprises generally. The importance of AFORES and its position as anchor investor within the Mexican capital markets is likely to continue and potentially increase.

AMLO's plan also includes fostering more competition in the banking sector, where it highlights the concentration of the Mexican banking sector and the stagnation of the Mexican Stock Exchange. To this end, the plan proposes (1) differentiated regulation for small, medium and large banks, (2) more support for new participants, such as niche banks, and (3) to promote the use of new technologies (i.e., fintech).

Since election day, AMLO has met with, and received the support of, most local business and trade organisations, including those that opposed his candidacy during the election process. So far, financial markets have been stable to positive, and given AMLO the benefit of the doubt (since 1 July 2018, the Mexican peso has rallied 3.1578 per cent relative to the US dollar). As this publication goes to press, the North American Free Trade Agreement negotiations seem to be moving towards a good outcome for all three partners. In general, Mexico's regulatory framework and sound macroeconomic outlook has made most economic analysts maintain their view that the Mexican economy continues to be in a period of expansion.

With the election over, and the economic policies announced by AMLO during the transition phase, a good portion of the uncertainty affecting the M&A market during the past 18 months has subsided considerably. The expectation is that with the waning volatility, local valuations and multiples will become more stable, which should translate into a more active M&A market, particularly for international financial sponsors that have largely remained on the sidelines on account of the exchange rate volatility.

Mexico's demographic trends continue to show an economy less dependent on exports, a growing middle class and increased consumerism (with more access to consumer credit), which suggests ample investment opportunities in sectors serving domestic consumption, such as financial services, healthcare, retail, pharma, education, dwellings and agro-industry.

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