

United States - Mexico Law Journal

Volume 9 Presentations at the Ninth Annual
Conference


Article 17

3-1-2001

Private Placement of Mexican Securities: Mexican Law Issues

Francisco Carrillo Gamboa

Follow this and additional works at: <https://digitalrepository.unm.edu/usmexlj>

 Part of the [International Law Commons](#), [International Trade Law Commons](#), and the [Jurisprudence Commons](#)

Recommended Citation

Francisco Carrillo Gamboa, *Private Placement of Mexican Securities: Mexican Law Issues*, 9 U.S.-Mex. L.J. 153 (2001).
Available at: <https://digitalrepository.unm.edu/usmexlj/vol9/iss1/17>

This Article is brought to you for free and open access by the Law Journals at UNM Digital Repository. It has been accepted for inclusion in United States - Mexico Law Journal by an authorized editor of UNM Digital Repository. For more information, please contact disc@unm.edu.

PRIVATE PLACEMENT OF MEXICAN SECURITIES: MEXICAN LAW ISSUES

LIC. FRANCISCO CARRILLO GAMBOA*

The regulatory framework of Mexican law is quite limited in its scope. Unlike private placements in the United States, in Mexican securities law there are no safe harbor provisions¹. There are certain Mexican legal issues that arise in connection with private placement of securities between the United States point managers, or venture capital funds, and closely held Mexican corporations. Recently, due to the increase in the Mexican capital markets, it has been very important for closely held Mexican corporations to look for financing either through debt or equity. When financing through equity, some companies are unable to make international IPOs² or access the Mexican IPO market. However, they are more interested in being closely held, having financial providers give them capital resources, and having Mexican companies to associate with other technical assistance or technical providers. It is becoming commonplace to see point managers from Mexican capital markets investing in Mexican companies, due to the high rate of return. Although there is a very limited liquidity for those shares, they are closely held. The limited availability of shares serves as a mechanism through which the Mexican corporations and the foreign financial providers go into financial joint ventures.

There are other reasons for closely held Mexican corporations. The first is the negotiation process with a foreign point manager. Here, the negotiation process begins with disclosure and due diligence. Disclosure consists of releasing information that a company is required to provide. A listed corporation must follow the disclosure requirements. Closely held corporations must also comply with disclosure, which is also referred to as a contractual disclosure. The disclosure level is based on the agreement signed between the financial provider and the Mexican company. Consideration is given to the level of disclosure required for due diligence and for the devaluation of the company. In the devaluation of a company, the financial provider normally looks to various international accounts and financial mechanisms. Today, there are sophisticated valuation formulas and core agreements used in these types of transactions.

In addition to valuation and disclosure, another significant element is the business plan. The financial provider will expect a very specific detailed business plan in which the closely held corporation can advise its potential, privately limited, shareholders what it proposes to do with the capital and future joint ventures. The financial provider will also consider whether the business plan should list the company in the major stock exchange, global stock exchange, or Mexican stock exchange. Those principles are set forth in the following agreements. First, there is usually a subscription or a securities purchase agreement. The second is a put

* Francisco Carrillo Gamboa is a member of the Mexican law firm Bufete Carrillo Gamboa, S.C. His areas of practice include Corporate Law, Banking Law, and Securities Law. Lic. Carrillo Gamboa was admitted in Mexico in 1978. He is a member of the Mexican Bar Association and the Mexican Securities Law Association. Lic. Carrillo Gamboa is a graduate of Escuela Libre de Derecho (LL.B.); Harvard University (LL.M., 1979).

1. Safe Harbor provisions prohibit suits based upon forward-looking statements, unless the statement was made "without a reasonable basis or was disclosed other than in good faith." 17 CFR 240.3b-6.

2. An Initial Public Offering is the first sale of stock by a company to the public. IPOs are often smaller, newer companies seeking equity capital to expand their businesses.

agreement. Next, there is a shareholder's agreement. Finally, a registration rights agreement is created.

The subscription agreement is a document that is governed by New York law. The company and the controlling shareholders are submitted to a foreign jurisdiction, such as the New York courts. In the subscription agreement the following are set forth:

- the class and purchase price of the securities;
- the representations and warranties applicable to the company and the controlling shareholders;
- the business plan;
- the financial information and the projection up to the closing date;
- the covenants.

Covenants require the controlling shareholders to list the company in the Mexican stock exchange or make an international IPO within a specific period of time.

Put agreements are used where the conditions are not satisfied and the financial provider is left without a mechanism for exiting where there is no ready market for the shares. In order to comply with U.S. regulations in connection with private placements and to avoid putting the financial provider under a possible liability of being an underwriter under United States securities law, there is a clause for representations and warranties in connection with the present investors. Investors declare with representations and warranties that they are doing the investment for their own account only.

Another important clause in this agreement is the indemnity clause. The clause has to be drafted as broad as possible in order to protect the financial provider from any misleading representation or event. U.S. counsel assisted in getting the 10(B)(5)³ liability language in this clause. Since this is a privately held corporation, all the liability and disclosures have to be agreed upon in the contract.

The shareholders' agreement covers the confirmation of the board of directors, the minority rights to be provided to the financial provider, and supplies the mechanism by which certain buy-out formulas would be provided in the agreement. Within the shareholders' agreement, items such as first options going to the controlling shareholder, buy back mechanisms, and clauses for the controlling shareholder are included. A buy-sell clause is usually established where there is a private placement by the controlling shareholders or in the event that there is a deadlock situation due to voting mechanisms. The buy-sell clause should be carefully drafted. It is an important clause since a buy-sell can take you to litigation in Mexico under the claim that the corporate purpose of the company cannot be achieved in a buy-sell clause. This creates a situation in which the company is subject to dissolution and repudiation arises.

The shareholders' agreement also provides for jurisdiction and indemnities. In certain cases we submit the shareholders' agreement to New York law and to New York jurisdiction. In addition to this agreement, the Mexican bylaws are amended in order to make it legally enforceable against the minority and controlling

3. 10(B)-(5) is a provision in the Federal securities law that prohibits fraudulent and misleading activities in securities transactions.

shareholders, and others. Included in the bylaws should be all of the principles that we have included in the shareholders' agreement. The bylaws basically set forth first options, buy backs, and other contractual restraints in order to safeguard the enforceability of the clauses. Normally the financial provider will request an IPO be made within a certain time frame. To enforce the IPO, a registration rights agreement is drafted. Unlike in the United States, in Mexico it is difficult to enforce a registration rights agreement because a Mexican IPO, under Mexican securities laws and regulations, requires that the company approve the IPO. Shareholder resolution is needed to approve the IPO and the board of directors of the Mexican company must approve the prospectus. To enforce a registration rights agreement and make a secondary offering in Mexico is difficult. Although the agreement is created, it is difficult to compel enforcement and simply becomes a gentleman's agreement⁴ for purposes of negotiations.

For the Mexican IPOs, the put agreement is used. This agreement allows the financial provider to put the shares on the controlling shareholders. There would be a joint and several liability of all the controlling shareholders. There would be price strike events and also we would have a very specific valuation formula enabling a recap of the best capital gain for the financial provider. In certain instances, requests from a money venture bank, a stand by letter of credit enforcing the payment under the put shares will be readily made. The put agreement would be subject to New York law, New York courts, and would become a direct liability of the controlling shareholder. If the controlling shareholder is a corporation, Mexican auditors request that a note be placed in the financial statement.

The put agreement signed by the individual and a Mexican trust by which certain liquid assets of the individual would be set aside for purposes of enforcement, payment, and the payment of the commissions payable under the letter of credit.

These are the documents, which are drafted in a joint venture between a financial provider and a closely held Mexican corporation. There are legal issues applicable to Mexican law. The first and major legal issue is specific performance. The theory is not to compel specific performance by bringing a legal action in the United States to enforce the joint venture documentation. However, a more favorable solution is to enforce the put agreements against the controlling shareholders. Though, there must be Mexican counsel with U.S. counsel to the extent that there is sufficient jurisdiction in a foreign court to compel enforcement of the put agreement against the controlling shareholder. The risk involved by submitting to a jurisdiction that controls shareholders during the time the put agreement becomes effective and at the time the put becomes a payable obligation is that the case can go to U.S. district court. The challenging party may request an injunction because the put agreement is against the ongoing nature of the business affair of the company and it jeopardizes the nature of this closely held corporation. Although two injunctions have been granted, a letter of credit is also needed. Where there is an injunction against the enforcement of the put agreement, the letter of credit against the bank is enforced.

In conclusion, the issue of Mexican public policy is a concern. To enforce these documents in Mexico, they should be enforced against a Mexican corporation, that

4. An unsigned and unenforceable agreement made between parties who expect its performance because of good faith.

is the holding company of a subsidiary and the company is affiliated with the controlling shareholders. Mexican public policy should be carefully approached. The registration rights agreement, the subscription agreement, the shareholders' agreement or bylaws should not contain any provisions that violate Mexican public order, rendering it unenforceable under Mexican law.