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PANEL DISCUSSION ON RECENT AMENDMENTS OF MEXICAN BANKING AND SECURITIES LAW

MODERATOR: JOHN E. ROGERS, ESQ.*

Panelists: Lic. Luis Capín Lopez; Lic. Francisco Carrillo Gamboa;
Lic. Eduardo Martinez Rodriguez; Lee Polson, Esq.

JOHN E. ROGERS: Eduardo Martinez noted that an arbitration clause can be included in a shareholders agreement and can also be included in the bylaws, or estatutos. However, the role of the shareholders agreement is different: some provisions that are useful to have in the shareholders agreement may not be suitable to put in the bylaws because of their public nature. The bylaws must be registered and are open for inspection by the public to a great extent. It seems to me that there is a real risk of inconsistency. For example, one arbitration proceeding could be initiated pursuant to the shareholders agreement, and another could be initiated pursuant to the bylaws, with inconsistent results. Do you think that is a real risk?

EDUARDO MARTINEZ: Certainly it is a risk. We have seen it vis-à-vis arbitrations, Mr. Rogers. We have seen it vis-à-vis Mexican courts and arbiter tribunals. In only one case that I know of—and if somebody knows of other cases, it would be good for them to comment—Mexican courts ruled that the arbitration should go forward. This was a very technical case, with a dispute as to financial statements and disclosure of financial information among the shareholders. One shareholder opposed the arbitration and went directly to court. Finally, in about three months (which is amazingly fast), in the first instance the court said no, you have to go to arbitration. The party did not follow up and we finished in arbitration on that regard. But certainly, if you do not draft your documents very clearly and are not extremely knowledgeable of what you are doing within the shareholders agreement and bylaws, you will have these conflicts.

ROGERS: One way of approaching this is to include in your shareholders agreement an arbitration clause or a provision to the effect that in the event of any conflict between the shareholders agreement and the bylaws, that the bylaws would control?

MARTINEZ: I've seen it both ways. The bylaws can control or the shareholders agreement can control.

ROGERS: But would that be valid?

MARTINEZ: Yes, that would be valid. Again, in the corporate rights, in the economic rights, and in the information rights, if you have the same wording in your shareholders agreement that is in the bylaws, it would certainly work.

ROGERS: Lic. Capín, do you see any problems with putting an arbitration clause in the bylaws? Are there provisions that you feel would not be subject to the shareholders?

LUIS CAPÍN: Lic. Martinez made the comment that there are some provisions that may or may not be enforceable due to public order. Also, they may or may not be enforceable because of the timing provided by Mexican law in order to be able to react, which would not be possible to do through arbitration. My suggestion in this case is that if you were going to put an arbitration clause in your bylaws, you

* A summary of the background of each of the participants in this panel follows on the last page of the discussion.

would have to include the exception for specific cases. That is an arbitration law in which the parties would be able to go to court in order not to have a party playing both ways saying yes, I want arbitration, or, no, I don't want arbitration. Another thing that I consider important is that through the formation of the corporation there is a contract. Both Lic. Martinez and I tried to stress that. There is a contract between both parties. But as soon as the corporation is formed, it is considered a legal entity independent of the shareholders. At that time it is created as an institution, and the bylaws control two types of relationships: the conduct of this entity vis-à-vis the shareholders and the relationships among the shareholders. There are clauses that relate to one or the other. The fact that these shareholders dispute with respect to their rights vis-à-vis the corporation, or their rights among themselves, that will be, for example, the right of first refusal and all the creative clauses that we have invented for the sale of shares of the corporation. The corporation doesn't have to do anything about that. The corporation is just an entity. This is a dispute between shareholders. That is handled through the shareholders agreement or is included in the bylaws because it is a contract among shareholders. That's something that could go to the arbitration, and it shouldn't be a problem. But the fact of adopting a resolution by shareholders' meeting or by a board of directors against the bylaws of the corporation, which affects third parties or which averts one of the shareholders, should be really examined more closely. Who is the entity and who is the board and the original body that will be able to protect that? Arbitration? I would say courts.

MARTINEZ: In that regard, certainly many arbitration rules of the various institutions like the International Chamber of Commerce (ICC)¹ and the American Arbitration Association (AAA)², et cetera, will allow parties to establish arbitration clauses and make any exceptions that the parties want in order to go to the national courts, as Lic. Capin was saying. It is important to do that in the drafting, if you want to do that.

ROGERS: Another question that I would like to throw out to everyone is: When we get to publicly traded companies, clearly there is a major difference between the securities markets in Mexico and the securities markets in U.S. The difference exists not only in terms of size, number of issuers, breadth of share ownership, but also the fundamental fact that in Mexico most publicly traded companies are not true public companies in the sense that they are in the U.S. In most cases there is a controlling group, and the publicly traded shares are really held by a minority. I think Mr. Polson touched on one of the issues that will be played out differently in Mexico than in the U.S.: that the dynamics for exercising shareholders rights are different. Basically in the U.S. you exercise them by buying or selling, whereas in Mexico that's not as much of an option. I wonder if these recent changes in Mexican law and regulation will bring Mexico closer to the U.S. model or will it require something more?

1. The International Chamber of Commerce (ICC), founded in 1919, is the world business organization. It promotes an open international trade and investment system and the market economy. It also provides as a service the International Court of Arbitration.

2. The American Arbitration Association (AAA) is the United States' largest full-service alternative dispute resolution (ADR) provider, assisting in the design and implementation of ADR systems for corporations, unions, government agencies and the courts.

FRANCISCO CARRILLO GAMBOA: In my opinion the shareholders' rights still exist under a principle of having to prove that you are an equity holder in Mexico and complying with the provisions set forth in Mexican law in order to be able to participate in shareholders' meetings. Nevertheless, one thing that is part and parcel of the United States are the proxies. Now, the Mexican Securities Act³ requires that all the issuers have proxy documentation available so that the shareholders are represented in the shareholders' meeting and are able to specify how they want to vote their shares at the meeting. In comparison with the United States, it is a question of culture in Mexico because we have to be able to advise our investors in Mexico that at present the right to vote on a certain matter is a right that has been conferred to them and not to the institutions that normally represent shareholders in publicly traded companies. Mexican practice for many years has been that the intermediaries attend the shareholders' meeting and exercise their voting rights, because there are three holders. They are the holders of the equity. Now with the change, Mexican investors or foreign investors will be able to actually inform the custodian how to vote on the shares, provided that they comply with the voting procedures. An important issue is how to vote on the shares. The voting instruction will be from the holder to the custodian so that the custodian can go to the meeting and exercise the rights.

ROGERS: It is a little more complicated when we talk about foreign owners of American Depository Receipts (ADR)⁴. How does the procedure differ?

CARRILLO: That is more complicated if you are a holder of an ADR. Number one: we have to know what is the underlying equity and whether that gives you full voting rights, limited voting rights, or no voting rights in Mexico. The ADR is an instrument that is issued in the United States, but in Mexico the ADR as an underlying instrument has an equity security. Assuming that you have full voting rights, because the ADR represents common stock in Mexico, consider the following. The ADR holder would have to request that the custodian in the United States give them the necessary evidence that they are a holder of the ADR. Also, there will have to be an instruction by which the ADR holder would go to the custodian—not to the U.S. bank but to the custodian in Mexico on behalf of the U.S. bank—and justify the U.S. bank's voting right. Then the Mexican custodian would attend the shareholders' meeting following the instructions of the ADR holder, or following the instructions as an attorney-in-fact of the foreign issuer of the ADR holder. In practice, they do not attend shareholders' meetings because normally the Mexican custodian would represent the shares based on the fact that since the Mexican custodian did not receive an instruction that the ultimate holder wanted to attend, the Mexican custodian would attend the meetings and exercise voting rights. First, you have to justify that you have an interest in the shares, then you have

3. The Mexican Securities Act is also known as the *Ley de la Comisión Nacional Bancaria y de Valores* (Law of the National Banking and Securities Commission). The text is available at: <http://www.cddhcu.gob.mx/leyinfo/46/>.

4. An ADR is an instrument traded on a U.S. securities exchange or over the counter that is issued by a U.S. bank and represents a specified number of shares in a foreign corporation. ADRs are bought and sold in the American markets just like regular shares. An ADR is issued by a U.S. bank and consists of a bundle of shares of a foreign corporation that are being held in custody overseas.

justify to the Mexican custodian that you have the beneficial interest and you have the right to vote the shares.

LEE POLSON: I have a couple of comments and then a question. First of all, a major difference in the United States is that typically the brokers' and dealers' institutions that hold securities in street name for beneficial owners do not vote those shares absent a specific instruction from the account holder. Instead, the proxy rules require that an institutional holder, such as a depository trust company or an individual broker-dealer, make arrangements to distribute the proxy statements to all the beneficial holders. There is a fairly complicated procedure for doing that, then they follow those instructions. But if an individual does not send back proxy instructions generally, the institution will not vote those shares at all, see, and that in effect is a no vote. So it's a problem in the United States to get the shareholders to vote since the institutions will not vote for them. My question is, ADRs are generally used in the United States mainly to facilitate investments by more passive investors like me, so I assume that if a major shareholder from the United States is investing Mexico in a big way, they're going to insist on direct ownership of the shares rather than ADRs, correct?

CARRILLO: That's true. ADRs are used basically for initial public offerings (IPO)⁵ of Mexican companies. If you are a major investor, you would request other types of securities that would give you direct voting rights in Mexico.

ROGERS: One final question, then we'll turn it over to the audience. One of the differences between the U.S. and Mexican contacts is clearly that the breadth of the capital markets in Mexico is much narrower than in the U.S. One of the reasons for that is pension funds don't invest in equity markets in Mexico to the extent that they do in the U.S. So my question is: what are the prospects for opening up some of the restrictions that currently apply to pension funds investing in equities in Mexico, and how much potential is there for that step leading to the creation of truly public corporations in Mexico?

CARRILLO: Right now, pension funds are one of the major institutional investors of Mexico. The reason is that they're considered institutional not because they're investing in equity; they're not permitted to invest in equity. But they are institutional in the sense that there could be long-term shareholders or equity investors in Mexico due to the amount of assets that they have under management. The possibility of permitting these pension funds to enter into the equity market is currently being discussed. First, it would help transparencies. Second, it would help accountability. Third, it would help make a proper evaluation of the Mexican equity market. Nevertheless, there is a political issue here and that is since the pension funds handle the resources of the Mexican unions, in the sense the workers, there is the policy issue as to what extent we could be confronted with a crisis like we had in 1994-95⁶, as to the stability of a financial system, but there the stability of the welfare of social interest in Mexico. But I personally think it would help us in

5. An initial public offering (IPO) is the first sale of stock by a company to the public. IPOs are generally offered by smaller, newer companies seeking equity capital to expand their business.

6. In December 1994, the Mexican peso lost almost 30 percent of its value against the dollar after the government abandoned a 7-year-old plan to keep the currency stable. (*The Houston Chronicle*, Dec. 24, 1994, page A1.) The devaluation crisis affected almost all of Latin America and burdened many countries with foreign debt.

valuation and transparency of the Mexican markets if we let people invest in equities.

MARTINEZ: In that regard you also need to think of the conflict of interest if that market is open to really invest in the equity by these companies.

ROGERS: Lic. Carrillo, have the latest legislative changes addressed the issue of conflicts of interest, at least with respect to brokerage firms?

CARRILLO: Yes, it has. At the same time, since the law was enacted the retirement funds have independent directors and investment committees, and the investment decisions in the funds are taken by an investment committee composed by the majority of independent directors. But the board has to approve or confirm the investment decisions. Therefore, to the extent in Mexico and worldwide, we have confidence in the fiduciary capability of an independent director. Nevertheless, as Lic. Martinez says, there could be a potential conflict of interest issue. At least, there could be a prima facie incidence of conflict of interest if we see that non-independent directors are making the decisions to invest in equity.

ROGERS: Mr. Jáuregui?

MIGUEL JÁUREGUI: I would like to elaborate on the panel's comments. What we're looking for is transparency, security of transactions with securities, and we're looking for prompt disclosure of any irregularities. The reason we're trying to do that, and I may be pointing out the obvious, is because the transparency of the security will be equal to the appetite of the market for that security. Moreover in your scenario, John Rogers, you were describing to the retirement fund directors being able to invest, it hinges on the transparency and propriety of the issuer and the propriety of the governance of the issue and on the actual value, which is what Mr. Carrillo Gamboa was saying about the real value of the security if you're dealing with fiduciary funds of savers. I would like to put two points to Mr. Polson and certainly to Mr. Carrillo, as well as any of the members of the panel. My law firm is representing the SEC⁷ in the recent insider trading issues, and we have found a couple of serious issues. First, we don't have harmonization of procedures between the U.S. and Mexico in order to take depositions of people in Mexico and in order to follow an orderly procedure of the SEC investigation in our country. If we are to trade in public securities of Mexican issuers in the U.S., or to use ADRs, there needs to be harmonization. It is also necessary to be careful that Mexican procedures are observed in the U.S. and U.S. procedures are observed in Mexico. We now see in the registration of Citigroup⁸ as a public company in Mexico that we're going to need the reciprocal sort of understanding and harmonization. For instance, there is a situation that hopefully will improve in Mexico through the Securities Market Law.⁹ That is, many times, the Mexican Comisión Nacional

7. The Securities and Exchange Commission (SEC) was created by the U.S. Congress to regulate the securities markets and protect investors. The SEC enforces the Securities Act of 1933. The statutes administered by the SEC are designed to promote full public disclosure and protect the investing public against fraudulent and manipulative practices in the securities market.

8. In August 2001, New York-based financial corporation Citigroup purchased Banamex, Mexico's second largest bank.

9. The Mexican Securities Market Law (*Ley del Mercado de Valores* or LMV) regulates the issuance of a corporation's stock and the voting rights associated with shares of stock. http://www.bmv.com.mx/bmv/ley_val.html

Bancaria y de Valores (CNBV)¹⁰ has missed the opportunity to look into insider trader issues, because the statute of limitations has run or because they didn't see any purpose in looking at it since there was no criminal or at least civil remedy. My view is that the more technical you become in the securities market, the less you will use criminal prosecution and more the civil restitution, which is where I would like to wind up. So, comments, please?

ROGERS: Mr. Polson?

POLSON: I have a couple of comments on the process, and Mr. Martinez has some comments on insider trading in particular. The emphasis on the civil side of securities enforcement in the United States is more institutional than statutory. All these things are crimes. But the SEC has the authority to bring its own civil lawsuits for injunctive relief, including disgorgement of illegally obtained profits, in order for them to prosecute. They can't prosecute a crime themselves; it must be referred to the Justice Department and/or to individual U.S. Attorneys and, frankly, that is not a major emphasis of the Justice Department. It hasn't been for years. They are swamped with drug cases.

MARTINEZ: The situation is that there is an information agreement between the CNBV and the SEC, and the way we have seen it and we have participated in a few cases of investigation with the SEC, is, in Mexico, you will have to go through CNBV if the only thing the SEC wants is information. First, people will have to appear and go through the SEC procedure on a voluntary basis. Second, we have seen the SEC going to the U.S. courts and try to subpoena Mexican parties, or it is also possible, although we have not seen it, for the SEC to come directly to Mexican courts. The current trend is that the CNBV, if it doesn't want to be put aside, will have to participate much more and reach a level of cooperation with the SEC. I don't think that they have any other way around but just to participate with them.

ROGERS: Lic. Carrillo, do you have any comments?

CARRILLO: Well, number one, in the amendment to the Securities Act, it is provided that now the CNBV has the authority to take depositions in Mexico. That will be very useful because under the Memorandum of Understanding (MOU)¹¹ between the SEC and the CNBV, we could act more promptly if we are representing the prosecutors. If we are representing the insiders, we have a question of constitutionality of the Mexican CNBV statute; therefore you could have certain rights of actions for depositions being taken in Mexico. But I fully agree that the SEC could go through the CNBV, the Mexican State Department, or the Mexican courts.

ROGERS: So in other words, you see this process potentially being tied up by *amparo* proceedings¹², which would prevent the disclosure?

10. The *Comisión Nacional Bancaria y de Valores* (CNBV) is the entity that oversees the Mexican securities market, and in general, Mexico's financial sector.

11. Memorandum of Understanding between the U.S. Securities and Exchange Commission and the *Comisión Nacional de Valores* of Mexico on Consultation, Technical Assistance, and Mutual Assistance for the Exchange of Information, International Series Release No. 181 (Oct. 18, 1990).

12. *Amparo* proceedings are summary proceedings of Mexican courts, which serve to guarantee constitutional rights.

CARRILLO: The idea is that the CNBV can act promptly in all investigations through depositions and through the MOU. That is, the SEC could request the CNBV to take depositions in insider trading investigations.

JOHN WALSH¹³: I have two questions related to the enforceability of agreements among shareholders in joint ventures. First, with respect to arbitration clauses, is it possible in a shareholders agreement to specify not only that any disputes will be arbitrated, but they will be arbitrated using some law other than Mexican law, assuming we're talking about a Mexican corporation. Second, a fairly common shareholders agreement in international transactions would be one in which there were multiple shareholders. For example, two shareholders get together and say before any shareholders' meeting, we're going to meet. We're going to agree among ourselves or make a decision as to a particular issue or all the issues at the shareholders agreement, and then each of us is bound when we actually get to the shareholders agreement to vote that way, even if we objected in the pre-meeting meeting. Would that be enforceable under Article 198¹⁴ of the Mexican law?

MARTINEZ: As to your first question, it wouldn't be in the parties' best interest to submit the agreements or the part of the documents to different laws. If you are dealing with a Mexican company, you should stick with Mexican law. Also, as I said, in connection with the corporate information and economic rights of shareholders under the corporation, you have to stick to Mexican law. But certainly if you have other agreements under your master contribution or shareholder agreement, you can submit it to whatever law you wish to, and certainly either to arbitration or to local courts. As to the second question, which is more difficult in that regard, the meeting that you are describing among shareholders would be in violation of Article 198. Certainly, the important element would be to prove it, either in arbitration or in court. The only way to prove it would be in writing. Evidence of witnesses, that they met in a certain hotel, or flew together from Mexico City to the United States and were chatting about it is not very useful. You need hard evidence in order to prove the point that they agreed and therefore violated Article 198.

CAPÍN: As to your first question, I think in reality you will not be able to make it under New York law because in that case, it will not be considered a Mexican company. That is because Mexican companies, by the commercial code, are the companies which are incorporated in accordance with Mexican law. So if you are going to be using, say, New York law for purposes of deciding how shareholder meetings are going to be treated, it will not be considered a Mexican company.

ROGERS: Could you envision a kind of dual governing law provision in the shareholders agreement under which everything not covered by the bylaws, for example, would be governed by New York law?

CAPÍN: Nothing which is covered by the bylaws under Mexican law will be dealt with under New York law, maybe, but what happened there is that everything would be covered because Mexican law will also apply, maybe application supplementary of other Mexican regulations. It would be very difficult to find a

13. John Walsh is an attorney with Hill and Robbins in Denver, Colorado.

14. Mexico's General Law of Corporations (*Ley General de Sociedades Mercantiles* or LGSM), enacted in 1934, sets forth the basic provisions for incorporation of corporations, shareholders' rights, management and oversight of management, and financial performance. <http://www.cddhcu.gob.mx/leyinfo/144>.

case in which you will find something that is not there. To the extent that you have soft information in the trade secrets under the joint venture agreement, I would say the question is whether you're more protected if you have an injunction from a court in the United States or if you go through arbitration. It's just a question to my colleagues.

MICHAEL OWEN¹⁵: I have a question for Lic. Carrillo. I'd like to try to flesh out the definition of independent director. You indicated that there is no definition of independent director. In the 1980s and certainly right now, during the debt restructurings, one situation that develops often is that bank creditors are asked to capitalize part of their debt and receive equity in the company. On numerous occasions they need, as a part of that, to elect directors that they nominate. Often those directors do not come from the banks; they are very well known, highly respected business executives in Mexico. My question is: simply because they are in effect nominated by a group of shareholders, in this case the bank creditors, do they lose their status as independent directors or would they still be considered as independent directors?

CARRILLO: Due to the fact that the directors are nominated by the banks who are equity holders, there is the risk of that independence being lost. Nevertheless, I have a case of an issuer in Mexico, a Mexican-listed company, and we're looking to have a very objective interpretation of the degree of independence. The argument is that even though I have been nominated by an equity holder, I have an independent business judgment. So the issue is not resolved, but under the Mexican Securities Act, it would not qualify as independent. That is a question of interpretation right now.

ROGERS: Mr. Loera?

ORLANDO LOERA¹⁶: One of the comments is that holders of 15 percent of the shares can bring actions against the board under the changes in the law. What action can they take, for what type of activity, and where would that action be adjudicated?

CARRILLO: The actions are similar to those for non-listed companies, but instead of having a 33 percent equity interest, it is lower. In order to bring that action, first you need a shareholder resolution saying there was a lack of professionalism by the directors. In other words, you cannot request a direct action if there is no shareholder resolution that imposes liability. Second, the threshold of the equity ownership is enabled to bring that action, but you need a decision of the shareholders that there is liability on the part of the directors.

MARTINEZ: I think that first of all you cannot go directly to court and sue your director if you don't have a previous stockholders meeting in which you voted against the actions of those board members. If you have such a vote, then you have the right to go to court. But you must have the objective measure of civil responsibility and consider what damage or harm are you doing to your interests or to your corporation. Again, evidence is an important element. You have to fulfill the formalities of going through the board decisions, through the stockholders decisions. Once these have been met, then you go to court.

15. Michael Owen is an attorney with Paul, Hastings, Janofsky & Walker, LLP, in Los Angeles, California.

16. Orlando Loera is an attorney at Bank of America in Mexico City.

ROGERS: If the dissenting shareholder is making the claim, how can it hope to get a shareholder resolution?

MARTINEZ: Well, you have to wait or you have to request the inspector or the same board to call a meeting, and if not, you go to court and ask to have a call published for a stockholders meeting. In that regard, you have certain rights as a minority shareholder to ask the board for a particular decision of the shareholders' meeting or to ask the inspector to publish the call.

MR. CAPÍN LOPEZ: I think that it goes back to my comment about the relationship between a corporation and the shareholders. I agree with Lic. Martinez. Article 161¹⁷ clearly states that the responsibility of the administrators will be required once the general assembly meeting has voted for that. However, also Article 163¹⁸ provides civil responsibility of the administrator against any shareholders. It then says at least 33 percent of the shareholders can go directly to the judge and request a judgment of civil responsibility against an administrator for any wrongdoings that have created a problem for the corporation and indirectly for them as shareholders.

STEVE KARGMAN¹⁹: This is a question for Mr. Carrillo. You had spoken about the expanded powers of the audit committee, particularly in respect to related-party transactions?

LIC. CARRILLO GAMBOA: Yes.

KARGMAN: I have two questions about that. First: is there any dollar or peso threshold? Second: if a shareholder believes that the board or company has entered into a transaction that is not at arm's length, can they bring a direct action in court or should they still go through this shareholders' meeting?

LIC. CARRILLO GAMBOA: First, the scope of the auditing committee's authority is something that has to be included in the bylaws. The law provides that they have to review related-party transactions, but the other activities have to be in the bylaws. In my experience, we normally endow the auditing committee with the responsibility of reviewing not only related-party transactions, but also management compensation, the level of disclosure of financial statements, and how they are prepared. Second, it would be possible at least to try to bring an action in court based on the fact that the auditing committee, after certain findings, concluded that under certain related-party transactions there was possible liability. This is because the auditing committee is a delegated authority of the board in certain cases. The auditing committee would request a professional opinion of fairness in connection with their conduct from a major accounting firm in Mexico. Third, with that the auditing committee would have to respond to a shareholders' meeting and at least give an assessment as to whether the director has a duty. In pursuing this action, you have the risk that a Mexican judge could say, "First we have to hear how the shareholders have discussed the matter in a meeting before we accept this type of action." But if we try to have it as a pejorative action, maybe it's something that could work. It's just a personal thought.

17. General Law of Corporations, *supra* note 14 above.

18. *Id.*

19. Steve Kargman is an attorney at the Export-Import Bank in Washington, D.C.

DOUG DOETSCH²⁰: I have two questions. First, on the derivative actions that have been discussed which a 15 percent shareholder may bring, I want to make sure I understand the sequence of events. Say there were a 15 percent shareholder who had a concern about a related-party transaction or some action that had been taken that was against the estatutos or some other independent director issue, for example, duty of care, duty of candor, anything that is perhaps not explicitly laid out in the estatutos. Would that 15 percent shareholder have to go to a shareholders' meeting that they've called?

CARRILLO: That's correct.

DOETSCH: So they would go to the shareholders' meeting, they would raise the question at the shareholders' meeting. Assuming that they're a minority shareholder, a 15 percent shareholder, the majority shareholders are quite satisfied with what's happened and are likely not to take any action. But the fact that a 15 percent shareholder has raised it as an initial matter at the shareholders' meeting, even if it is voted down or ignored, then they have the procedural right to petition for a derivative action? Do I understand the sequence correctly?

CARRILLO: No. You have to have the affirmative vote of the shareholders or you have to be a dissenting shareholder. Let's assume that the shareholders' meeting passes a vote and says that there's no liability. That's the end of the story.

MARTINEZ: In my opinion, it would be a two-tier process. First, you voted against it, so you have the right to oppose the resolution of the stock holders and file it in court before bringing your action against the directors. Except if the majority are engaged in bluntly illegal or criminal acts, then any minority shareholder can do it. If not, you will have to resort to a second-tier decision to fight the resolution of the majority shareholders, and the majority shareholders will have to prove that those actions were taken legally or not in violation of the general rules.

DOETSCH: So, to follow up, if the majority agrees with your contention that an action against the best interests of the company has taken place, then you can start a derivative action. Is that right?

CARRILLO: Yes. Right now, since you have auditing committees, the other question would be whether the opinion of the auditing committee could be not final but relevant in the shareholders' meeting. At that shareholders' meeting, you could also have the situation of conflict of interest of the represented shareholders. The report of the auditing committee could be very important in that case. Finally, if the auditing committee has sufficient evidence, a criminal case for mismanagement of assets is possible. That is a felony in Mexico. That could cover directors, officers, and any other person who has the custody of assets in Mexico. It is not a federal crime; it's a crime under Mexican state law. It's very efficient. Criminal charges on mismanagement of assets impose liability on management and directors.

DOETSCH: The second question that I had was to follow up on Mr. Owen's question about independent directors. He asked about directors appointed by banks that are major shareholders as a result of a debt restructuring. I think the answer was that it's not clear in the law, but your presumption was these independent individuals that would be nominated by the creditor shareholders would not be independent. My question is, if that is the correct interpretation, wouldn't that

20. Doug Doetsch is an attorney at Mayer, Brown & Platt in Chicago, Illinois.

likewise disqualify independent business people that are nominated? I assume these people are nominated every day by the majority shareholders precisely to be the independent directors that the company requires. That's because, both in the United States and, I presume, in Mexico, so-called independent directors are usually people that are nominated by the majority shareholders or majority blocks on the board who are known to be management-friendly. You don't voluntarily nominate to the board someone who's going to be unfriendly to you.

MARTINEZ: That is correct, and certainly there is no doubt we have a long way to go in that regard, even through court resolutions. The key test right now would be not only the nomination but the economic independence. There is a rule that if you are an independent member of the board, your income from that company or from that group of shareholders should not exceed 10 percent of your income. At least, that objective measure will start to bite whether you are independent or not. Certainly there will be cases that go to court and the court will decide whether you are independent or not.

LIC. CAPÍN LOPEZ: A very good thing is that lawyers are considered independent, right?

MARTINEZ: Provided you pass the economic test as well, because that's also important.

ROGERS: So does that mean that a lawyer who is counsel for one of the majority shareholders would be treated as a related party and therefore not independent?

MARTINEZ: Yes, such a lawyer could be treated as a related party. If he's receiving more than 10 percent of his annual income in that regard, then he will not pass the economic test and will not be considered independent.

DON HERNANDEZ²¹: It's not a question, it's really a clarification. Even though the law doesn't define what independent directors are, Circular 1133²² of the CNBV, which incorporates the Code of Government Practices, defines what disqualifies a director as independent. Therefore, as long as you're not within the disqualification list under Circular 1133, anyone else would be independent. That ought to clarify things.

ROGERS: Is that circular still in force?

CARRILLO: Yes, and let me just make this clarification. The case we're handling right now has to do with the representation of a director appointed by a bank as independent. The auditing committee's argument is that the director does not have any direct business affairs with the corporation, and that the bank that nominated this director does not have any further lending activities with the corporation. We're reviewing this in an auditing committee in which we are members. I'm a member of that auditing committee. It's a very important topic right now in Mexico.

POLSON: I just want to observe that in the United States, lender liability theories would make most banks very hesitant to ever appoint a director to a corporation that they've lent money to.

21. Abdon Hernandez, is an attorney with Servicios Industriales Penoles, S.A. de C.V., in Mexico City.

22. Circular 1133 of the CNBV dictates certain reporting requirements, including submission to the CNBV of economic, accounting and legal information. Economic and accounting information must be filed on an annual or quarterly basis.

JOSE LERMA²³: This question is for Lic. Martinez and the rest of the gentlemen as well. Lic. Martinez, you made a comment with respect to the reemergence of the *sociedad de responsabilidad limitada*²⁴ as opposed to the *sociedad anónima*²⁵, and also to the relatively recent preference for joint ventures in terms of business transactions in Mexico. You also pointed out several advantages because of changing conditions. One of them was open markets. Would you be able to amplify on this statement in terms of American or foreign investment in Mexico?

MARTINEZ: Yes. The experience was that basically for foreign reasons, not for Mexican reasons, the foreign investor preferred to use the *sociedad de responsabilidad limitada*, or limited liability company, which has a different structure in Mexico than the *sociedad anónima*. In that regard we saw a lot of joint ventures going that way, particularly hotel businesses or agricultural and cattle raising businesses. These joint ventures had incorporated the foreign element into their ownership, even what we call agricultural land for raising cattle or other agricultural purposes. Then, of course, there was industrial processing. In that regard, the tax advantage probably will disappear. These types of companies still enjoy a preferential tax treatment than the general tax treatment than all corporations have.

ROGERS: One point about the SRL, or the limited liability company, that we might want to touch upon is it's my understanding that an SRL cannot have its *partes sociales*²⁶ listed on the Securities Exchange. One issue that comes up in a private equity context is: do you want to make a private equity shareholder agreement with respect to an SRL if the ultimate objective or one of the possible objectives for some of the shareholders is to have the company go public?

CARRILLO: Yes. Under Mexican law, that type of closely-held corporation cannot be listed in the stock exchange because there is a provision under Mexican corporate law. So if we're making a joint venture and we want to have registration rights for secondary listing in Mexico in liquidity, I think we have to follow the *sociedad anónima de capital variable*²⁷.

ROGERS: One point of clarification. When we talk about a joint venture, confusion can arise because U.S. lawyers tend to refer to joint venture in a very broad sense as including any kind of entity or arrangement under which there are two or more major investors. On the other hand, under Mexican law, joint venture is sometimes used to refer to the *asociación en participación*, which is not a legal entity. Could someone describe that?

MARTINEZ: Right. The *asociación en participación* is a contract regulated under the corporate business law of Mexico. Basically it doesn't create a different entity. It just indicates the will of the parties. Under Mexican law there is no legal

23. Jose Lerma is an attorney at Lerma & Associates in Tucson, Arizona.

24. A *sociedad de responsabilidad limitada* is a Mexican limited liability company.

25. A *sociedad anonima* is a Mexican privately held corporation.

26. *Parte social* can be translated as "partnership interest," or what the partner of a general partnership or limited partnership owns.

27. A *sociedad anonima de capital variable* is a corporation that entails limited responsibility on the part of shareholders and indefinite corporate life, as its capital can be increased or diminished by a simple resolution by the board of directors, if allowed under the corporation's statutes. *CanadExport Online*, May 22, 1998, <http://www.dfait-maeci.gc.ca/english/news/newsletr/canex/980522ee.htm>.

definition of this kind of joint venture but certainly what we have discussed on this panel.

ROGERS: Any other questions?

MARCO HERNANDEZ²⁸: At least from the standpoint of the responsibility of the auditing committee or the compliance officer, these two entities usually depend on the board of directors, don't they? They report to the board of directors.

CARRILLO: They report to the board. Nevertheless, under the amendment to the Securities Act, their report has to go to the shareholders.

HERNANDEZ: If there are certain independent directors, then if they report something that needs to be vetoed, the spirit of the law would make it very clear that the flow would come from the controller, the compliance officer, or the auditing committee, to the board of directors. That is the whole purpose of the independent board of directors, to make evident to the shareholders something that needs to be vetoed.

CARRILLO: That's correct. Let me just give you one example. The Mexican FDIC²⁹ investments right now are subject to high scrutiny. Therefore, in the bylaws of the Mexican investments that are made by the FDIC, we have a provision for all the companies in which they invest that says that if the auditing committee of the corporation, by unanimous vote of those person who do not have a conflict, then the auditing committee through the bylaws has the right to request the inspector to call a shareholders' meeting and the auditing committee through the inspector will request the removal of the director.

ROGERS: I wonder if someone could comment on the role of the comisario and in the traditional sense, and to what extent have the comisarios fulfilled or not fulfilled the functions that were given to them under corporate law?

CAPÍN: The comisario, or the examiner in English, is the person who represents the shareholders in order to review, approve, and validate the actions and accounts prepared by the board. He responds directly to the shareholders and he is their representative. I would not say he does this in the day-to-day management of the company; it could be invoked if nobody wanted to have a comisario sitting there, overseeing the day-to-day management. But the obligation established in the law is that he has to review the annual accounts and report, and then approve them—or, if not approve them, he gives his comments and his point of view for approval by the shareholders.

ROGERS: When there are conflicts between a minority shareholder and the majority, under what conditions does the minority shareholder have the right to appoint its own comisario?

CAPÍN: In the privately held corporation that's over 25 percent and in a publicly held corporation, it's 10 percent. It's the same rules as for appointment of board members, as I remember.

ROGERS: Twenty-five for privately held and 10 percent for public. Question in the back?

28. Marco Hernandez Tracey is an attorney at Strasburger & Price, S.C., Mexico City.

29. The Mexican Central Bank *Instituto Para la Proteccion al Ahorro Bancario* (IPAB) is the Mexican equivalent of the FDIC. IPAB is a decentralized organism of the Mexican Federal Public Administration, created under the Law for the Protection of Bank Savings. <http://www.ipab.org.mx/English/about.html>.

MICHAEL GORDON³⁰: With regard to independent, or as we often call them, outside directors, there were some comments made about U.S. compensation committees and how they are often made up of outside directors. I don't think the intention was to suggest that these committees have had a significant impact on moderating the acceleration of executive salaries. Two things belie that. One is that the figures we see in *Business Week*, *Wall Street Journal*, and other publications suggest that the difference between lower management salaries and upper management salaries has accelerated over the last decade. Secondly, those outside directors are so often the executives of another corporation. If they were to try to moderate the salaries of those whom they're voting on, they ought to be careful because they may be suggesting that their own salaries back home are too high. Let me just ask another question that deals with a different matter. Several Mexicans form a small company. There's no shareholder agreement. They include in the bylaws a provision suggesting that all corporate matters should be determined by Mexican courts under Mexican law. After a while, one of those parties decides to move abroad. They enter into a shareholders agreement because that person is going to have a different kind of participation but still would like to remain a shareholder and receive some income. No provision in that agreement has anything to do with what courts may assert jurisdiction. The party abroad finds that the other two are skimming profits and violating several provisions that deal with both responsibility of corporate directors and with shareholder agreement rights. This case is filed in a jurisdiction outside of Mexico, where the Mexican parties have personal assets. The defense is that this matter should be governed under Mexican law and heard in Mexican courts. What should the American court do? Apply Mexican law? Move the matter to the Mexican court? Would a Mexican court respect an American judgment that was rendered against the Mexican defendants?

POLSON: First of all, you're right about the compensation of executives having increased, not decreased. The amount of information available on what that compensation is and how it compares has had some effect on the price of companies. In fact, I was involved in a hostile takeover this spring in which management was thrown out because shareholders were so incensed by their compensation arrangements. So the directors may not be modifying the compensation of management, but sometimes the shareholders are doing so, either indirectly or directly. As to your hypothetical, first of all, there wouldn't have been a violation of U.S. federal securities laws because there was no sale of securities in the United States. Second, since presumably the affairs of the corporation are being managed and continue to be managed, and here I'm presuming the affairs of the corporation are mainly Mexican. While I'm not a conflicts-of-law expert, I think a United States court would have to refrain from making any decision based on United States law. I expect the U.S. court would probably not hear the case at all until some decision had been rendered in Mexico that could possibly be enforced in the United States.

GORDON: Would the answer be different if, under the shareholder agreement and as in this example, the parties submitted to New York law and jurisdiction?

30. Michael Gordon is the Chesterfield Smith Professor of law at the University of Florida in Gainesville, Florida.

POLSON: Well, I think that there would have to be some sort of nexus with the United States operations before an American court would hear the case. But I don't think just choosing the law of the United States is enough to give an American court jurisdiction.

ROGERS: And even if it did and rendered a judgment, say, for injunctive relief, would a judgment for injunctive relief be honored by the Mexican courts?

MARTINEZ: It would be difficult if the other Mexican shareholders fight the venue of the foreign courts. What Mr. Polson is saying is perfectly right. If you had not only the choice, but also the relationship or some business transaction, the U.S. court will take jurisdiction and probably, if accepted by the parties, then the judgment would be enforceable in Mexico.

ROGERS: Another question?

KRUMBEIN³¹: This question should bring you back to the basic premise, the difference between having something in the bylaws, estatutos, versus having it in the shareholder agreement. The action on the shareholder agreement is strictly a private contract action between the parties. In essence, a corporation or third parties are not bound by the contract. That's the reason why you want to put those clauses in the bylaws as opposed to a shareholder agreement.

MARTINEZ: By all means. You want them to be in the bylaws for sure, and you can have them in your agreement. Now, what I understood is basically they are not committing corporate breaches in that regard, but violating economic rights. That's where you have possibly try other alternatives despite what you already agreed, but with certain conditions, like the venue, that there's not only the choice but that you are doing business in a certain part of the United States.

ROGERS: While we haven't used the "C" word, convergence, in fact we're seeing a good deal of convergence in this area. Mexican law is in some respects getting closer to U.S. law, at least concerning publicly traded companies. With respect to privately traded companies, there hasn't been as much convergence as of yet, but we may see more of that in the future, given that there is a general recognition that the corporate law in the Mexico, being a 1934 statute, may need some modernization in the coming years.

BIOGRAPHICAL SUMMARIES

John E. Rogers, Esq., is a partner in the firm of Strasburger & Price, LLP, and is in charge of the firm's Mexican subsidiary. Until July 1, 2001, Mr. Rogers was a partner with Carlsmith Ball's Mexico City office, which he was responsible for establishing in 1991. Before that he was Senior Counsel in the Legal Department of Bank of America in New York and Mexico City. He has been a resident of Mexico for 13 years and has broad experience in banking, finance, international corporate matters, and telecommunications. Mr. Rogers has been a frequent author of articles on banking and financing law including Mexican Corporate Banking in a North American Market, 2(9) Mexico Trade and Law Reporter (September 1, 1992), "NAFTA Dispute Settlement for the Finance Sector," Business Mexico (June 1993), "Project Finance Laws 1995: Mexico," Latin Law (March 1995), The Prospects for Modernization of Financing of Mexican Business (Symposium 1994, Presentations

31. Richard Krumbein is an attorney at Dorsey & Whitney, Denver, Colorado.

at the Second Annual Conference of the United States-Mexico Law Institute), 2 U.S.-Mexico Law Journal 139 (1994), "Reforming the Lending Policy," Business Mexico (Special Edition 1995), Using the "Brady Bond" Approach in Mexican Corporate Financings, 2(4) Mexico Trade and Law Reporter (April 1, 1992). Mr. Rogers is a member of the Association of the Bar of the City of New York (Chair, Committee on Inter-American Affairs, 1984-86); American and Inter-American Bar Associations; American Society of International Law; and *Union Internationale des Avocats*. He is also a member of the Vigilance Committee of the American Chamber of Commerce in Mexico. He received a B.A. from Harvard College and a J.D. from Columbia University. He was admitted to the New York State Bar in 1971.

Lic. Luis Capín López is a partner in the corporative law firm of Capín, Calderon, Ramirez y Gutierrez-Azpe. He was born in Mexico City. He received his law degree from the *Universidad Iberoamericana* Law School, in Mexico City and an LL.M. in International Law from Southern Methodist University Law School. He completed his post-graduate studies in Commercial and European Law at the University of Law, Economy and Social Sciences of *Panthéon-Assas* in Paris. He is Professor of Foreign Trade Law at the *Universidad Iberoamericana* Law School and Professor of International Commercial Contracts at the Institute for Post-Graduate Studies of the *Universidad Iberoamericana*. Lic. Capín López is a member of the Mexican, American (Liaison Member with Mexican Bar, International Law Section), and International Bar Associations and AIJA. He speaks Spanish, English and French.

Lic. Francisco Carrillo Gamboa is the Senior Partner of Bufete Carrillo Gamboa, S.C.; Mexican Securities Law Association; Legal Committee of the Mexican Stock Exchange. He is a member of the Mexican Bar Association, Mexican Securities Law Association, and Legal Committee of the Mexican Stock Exchange. His legal practice is primarily in the area of corporate law and banking and securities law. Languages are Spanish and English. Lic. Carrillo received a *Licenciado en Derecho* from the *Escuela Libre de Derecho*, Mexico City, in 1978 and an LL.M. degree from Harvard University Law School in 1979.

Lic. Eduardo Martinez Rodriguez is a partner in the firm of Martinez, Rodriguez y Asociados. He is also a Professor of Law at the *Escuela Libre de Derecho* and the *Universidad Iberoamericana*, Mexico City and Secretary of the Board of Directors of ABN AMRO BANK (Mexico) and a member of its legal committee. He practices in the areas of corporate law, banking, securities Law, aviation and maritime law, and arbitration. He is engaged in litigation with an emphasis on commercial banking and bankruptcy. He is a member of the *Ilustre y Nacional Colegio de Abogados*. Lic. Martinez Rodriguez received a *Licenciado en Derecho* from the *Universidad Iberoamericana* (Mexico City) in 1975.

Lee Polson, Esq., is a partner at Strasburger & Price, LLP, in Austin, Texas. Mr. Polson has 24 years' experience in securities and corporate practice. His practice includes representation of issuers in new offerings of securities and in compliance with the reporting requirements of the Securities Exchange Act of 1934. Mr. Polson counsels businesses on structuring new enterprises, shareholders' and partners' agreements, acquisitions and dispositions of assets. He also represents securities broker-dealers in regulatory examinations and enforcement matters before the SEC, NASD, and state securities regulators. His publications and presentations include:

The Intersection of Bankruptcy and Securities (with Edward L. Ripley), 15th Annual Advanced Business Bankruptcy Law Seminar, State Bar of Texas (1997), and U.S. State Securities Regulation and Market access, E.C. (1992). His professional affiliations include the State Bar of Texas (Chair, Securities Law Committee, Business Law Section, 1998-2000; Chair, Administrative Law Section, 1985); the American Bar Association (State Regulation of Securities Committee, Business Law Section); and the Bar Association of the District of Columbia. Mr. Polson is former Deputy Securities Commissioner of Texas and former Executive Director and General Counsel of the North American Securities Administrator Association. He attended the University of Texas, School of Law, J.D., 1974 and received a B.A. degree from the University of Texas with honors. He was admitted to the Bar of Texas in 1974.

