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A New Era: The Regulation of Investment in Mexico

Miguel Jauregui Rojas

Carlos de la Garza Santos

Sean McMillan

A NEW ERA: THE REGULATION OF INVESTMENT IN MEXICO

MIGUEL JAUREGUI ROJAS*

INTRODUCTION

As a result of Mexico's parallel efforts to modernize its economy and to open its economy to the world, the climate for investment in Mexico has dramatically improved. Three basic structural changes in the Mexican economy have brought this about: the first is Mexico's entry into the General Agreement on Tariffs and Trade ("GATT");[1] the second is the privatization and decentralization of companies controlled by the Mexican government, including banks; and the third, and the one most important for the purposes of this paper, is Mexico's desire to negotiate and to enter into the North American Free Trade Agreement ("NAFTA").[2] This paper will discuss the investment climate in Mexico and the coverage given to investment by NAFTA. Part I of the paper will provide an overview of the outlook for investment in Mexico, part II will deal with current Mexican law pertaining to investment, and part III will focus on the investment rules produced by NAFTA.

I. INVESTMENT OUTLOOK

A. *Expected Levels of Investment*

As a result of the three structural changes mentioned in the introduction, Mexico hopes to enjoy levels of investment sufficient to sustain its current economic model of development based on free trade and openness to foreign investment. The American Chamber of Commerce of Mexico ("AmCham") carried out a survey, with the assistance of McKinsey & Co., Mexico, to ascertain the expected levels of investment for the period 1992-1995.[3] The AmCham survey was carried out among fifteen very large corporations, nineteen large corporations, and twenty-two medium size corporations.[4]

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* Partner, Jauregui, Navarrete y Nader, S.C., Mexico City; Chairman, Mexican Legislation Committee of the American Chamber of Commerce in Mexico; Lecturer, Banking Law, Universidad Panamericana, 1987; Colegio Madrid; Lic. en Derecho, U.N.A.M.; admitted to Mexican bar, 1967.

1. Apr. 10, 1947, 55 U.N.T.S. 194, *reprinted in* BASIC DOCUMENTS OF INTERNATIONAL ECONOMIC LAW 3 (Stephen Zamora & Ronald A. Brand eds., 1990) [hereinafter GATT]

2. Oct. 7, 1992 draft, U.S.-Can.-Mex., ch. 11 [hereinafter NAFTA].

3. AmCham Business Advisory Council, Mexico Multinational Investment Outlook 1992-95: Survey Results (Aug. 1992) (on file with the *New Mexico Law Review*).

4. As defined in the AmCham survey, very large corporations are those with over 200 employees and with average annual sales of $765,000,000 (U.S.); large corporations are those with between 50 and 199 employees and average sales of $93,000,000 (U.S.); and medium size corporations are those with between 10 and 49 employees and average sales of $19,000,000 (U.S.).

The Amcham survey came to several preliminary conclusions. First, it concluded that if NAFTA were ratified, 79% of the very large corporations would maintain the same level of investment for the years 1992 to 1995, while 21% would invest higher amounts; that 53% of the large corporations would invest the same, while 47% would invest higher amounts; and that 48% of the medium size corporations would invest the same, while 52% would invest higher amounts. Second, it concluded that if NAFTA were delayed, 85% of the very large corporations would invest the same, while 15% would invest less; that 94% of the large corporations would invest the same, while 6% would invest less; and that 76% of the medium size corporations would invest the same, while 24% would invest less. Third, if NAFTA were voted down, 50% of the very large corporations would invest the same, while 50% would invest less; 50% of the large corporations would invest the same, while 50% would invest less; and 43% of the medium size corporations would invest the same while 57% would invest less.

The AmCham survey came to several conclusions with regard to levels of investment as well. The survey concluded that 94% of the very large corporations expressed that appropriate levels were being considered, while 6% felt the level was less than desirable; 63% of the large corporations expressed that appropriate levels were being considered, 32% felt they were less than desirable, and 5% saw them as much less than desirable; and 50% of the medium size corporations expressed that appropriate levels were being considered, 41% felt they were less than desirable, and 9% saw them as much less than desirable.

Finally, the AmCham survey came to several conclusions regarding the attractiveness of Mexico for investment. The survey concluded that 33% of the very large corporations consider Mexico's investment attractiveness as very high, 60% consider it high, and 7% consider it acceptable; that 32% of the large corporations consider it very high, 47% consider it high, 16% consider it acceptable, and 5% consider it moderate to low; and that 18% of the medium size corporations consider it very high, 32% consider it high, 46% consider it acceptable, and 5% consider it moderate to low.

The AmCham survey identified factors affecting investment behavior of very large, large, and medium size corporations. These results are as follows:

Very large corporations/factors affecting investment behavior

	Average rating
- Market attractiveness	87%
- Export platform	73%
- Profitability	80%
- Tax environment	41%
- Economic policy	75%
- Political environment	68%

Large corporations/factors affecting investment behavior

	Average rating
- Market attractiveness	83%
- Export platform	75%
- Profitability	75%
- Tax environment	45%
- Economic policy	75%
- Political environment	71%

Medium size corporations/factors affecting investment behavior

	Average rating
- Market attractiveness	82%
- Export platform	74%
- Profitability	68%
- Tax environment	35%
- Economic policy	72%
- Political environment	76%

As for the most grievous impediments for investment of very large, large, and medium size corporations, the AmCham survey identified the following:

Very large corporations/most grievous impediments for investment

- Political uncertainty	30%
- Economic uncertainty	30%
- Foreign investment and other regulatory constraints	20%
- Heavy bureaucracy and regulatory discontinuity	20%
- NAFTA uncertainty	20%
- Tax laws	20%
- Infrastructure deficiencies	20%

Large corporations/most grievous impediments for investment

- Tax laws	36%
- Infrastructure deficiencies	28%
- Political uncertainty	21%
- Economic uncertainty	21%

Medium size corporations/most grievous impediments for investment

- Tax laws	58%
- Political uncertainty	37%
- Economic uncertainty	32%
- Heavy bureaucracy and regulatory discontinuity	21%
- Cost inflation	21%
- Foreign investment law	16%
- Exchange rate uncertainty	16%

The AmCham survey, therefore, came to several general conclusions with regard to investment in Mexico. First, it concluded that corporate investment plans imply direct foreign investment levels of 3.8 to 5.7 billion dollars per year over the 1992-1995 period by corporations already established in Mexico.

Second, it concluded that NAFTA has had a very favorable impact. Specifically, NAFTA has raised 1992 investment plans over 1991 investment plans by nearly fifty percent, while 1992 levels of investment are expected to increase by a further ten to twenty percent on average for the period 1993-1995.

Third, it concluded that investment outlook is affected by NAFTA developments in numerous ways. For example, NAFTA ratification will not significantly increase investment plans except in the case of the large and medium size corporations, which account for less than thirty percent of total investment plans for 1992. In addition, a delay in the ratification of NAFTA will not decrease investment plans significantly, with only one out of six corporations lowering expected investment levels. NAFTA non-closure, however, would have a significant negative impact on investment plans, with fifty-three percent of the survey corporations lowering their investment.

Finally, the survey concluded that while assessment of Mexico as an investment country is generally very favorable, significant measures are required to facilitate targeting Mexico as a corporate investment priority. The most helpful factors toward this end appear to be the fine-tuning and further improvement of the tax environment, the improvement of the infrastructure, the streamlining of foreign investment and regulatory processes, and the creation of greater year-to-year consistency in regulatory patterns and practices.

B. Factors Affecting Investment

There are several factors adversely affecting investment in Mexico. The regulatory and legal framework most troubling to investment stems principally from the Law to Promote Mexican Investment and to Regulate Foreign Investment and its 1989 Regulations, even though the 1989 Regulations did help to liberalize foreign investment somewhat. Further legal hindrances to investment are created by the ever-changing tax laws and regulations.

The lack of a comprehensive and fully modernized infrastructure is another factor affecting investment in Mexico. For example, the lack of affordable, competitive, and accessible telecommunications and transportation systems represent important limitations for the competitiveness of Mexican producers of goods in the domestic and international markets.

The attractiveness of the Mexican market is also negatively impacted due to the lack of a larger purchasing power of Mexican consumers, as compared to the greater purchasing power of consumers of other countries with similar economic conditions to those of Mexico. This lack of purchasing power was prompted by the difficult economic conditions Mexico has experienced since 1982. Mexican consumers, although recovering, still are not fully rehabilitated; therefore, a strong consumer base is not as yet present.

II. EVOLUTION OF THE LAW TO PROMOTE MEXICAN INVESTMENT AND TO REGULATE FOREIGN INVESTMENT

The Law to Promote Mexican Investment and to Regulate Foreign Investment ("FIL") was published in the Official Gazette on March 9, 1973, and it entered into effect on May 9, 1973. In the opinion of many experts, the initial purpose of the FIL was to avoid the sale of already established Mexican-owned companies to foreign investors. The FIL was also intended to restrict and, in most areas of economic endeavor, to deter foreign investment.

The stated purpose of the FIL is to promote Mexican investment, to stimulate a just and balanced economic development, to consolidate Mexico's economic independence, and to regulate foreign investment.[5] As part of this regulation of foreign investment, the FIL restricts the acquisition of already established Mexican corporate entities (including the acquisition of fixed assets) by foreign investors to twenty-five percent of the entity. The FIL does, however, give the National Commission of Foreign Investments ("FIC") discretionary authority to allow acquisition of up to forty-nine percent.

The FIL also defines fields of economic activity and divides them into four groups. First are those activities reserved to the Mexican State, such as oil, basic petrochemicals, electricity, railroads, and nuclear energy. Second are those reserved to Mexican nationals or Mexican corporate entities without foreign participation, such as radio and television, gas distribution, and air and sea transportation. Third are those with a maximum participation of foreign investment of up to forty percent of the activity, such as secondary petrochemicals and auto parts. Fourth are those with corporate entities that have a foreign investment of up to forty-nine percent. The FIL gives discretionary authority to the FIC to allow a larger percentage of participation to foreign investment in those activities which fall within the fourth category. In addition, the FIL gives the FIC discretionary authority to regulate already established foreign-owned and/or controlled Mexican corporate entities in two areas—new economic activities and new lines of products.

Prior to the enactment of the 1989 Regulations of the FIL, FIC authorizations regarding new economic activities and/or new lines of products were very difficult to obtain and, if approved, were usually full of conditions and limitations. Processing of applications was usually cumbersome and delayed, and in many cases applications were denied by the FIC. Similarly, FIC authorizations regarding new establishments

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5. Foreign investment for purposes of the FIL is investment carried out by foreign individuals, entities, and economic units, as well as by Mexican corporate entities which are majority-owned and/or controlled by foreigners.

were very difficult to obtain and were intended both to prevent the opening of new establishments and to hinder the easy relocation and expansion of existing ones.

The foreign investment climate has been greatly liberalized, however, with the enactment of the FIL's 1989 Regulations. As a result of the regulations, approximately two-thirds of the economic activities which contribute to Mexico's gross national product were liberalized. Thus, important and varied activities are now open to companies with majority foreign ownership without the need of a prior authorization from the FIC. There also now exist no substantial restrictions on the transfer of technology, and the protection of intellectual property has been substantially enhanced.

A. Make-Up of the National Commission of Foreign Investments

The FIC is composed of the heads of the Ministries of Commerce and Industrial Promotion, Interior, Foreign Affairs, Treasury and Public Credit, Mines and State-Owned Industry, and Labor. The undersecretaries of these ministries are empowered to act as alternates at meetings of the FIC. The FIC holds monthly mandatory meetings and has the broadest authority and discretionary powers in a number of economic areas. These areas include dealing with foreign investment issues, establishing policies, and acting as a consultation body of the state and local governments with regard to foreign investment.

The Executive Secretary of the FIC is in charge of foreign investment in Mexico. The secretary is appointed by the Mexican President and has the authority to represent the FIC, to carry out its resolutions, to manage it, to prepare an annual report regarding its activities, and to utilize the resources of the FIC pursuant to its approved budget.

Through the 1989 Regulations of the FIL, the acquisition by foreigners of the equity or assets of Mexican companies not resulting in foreign participation in excess of forty-nine percent is authorized as a general rule. Foreign participation in excess of such limit requires the prior authorization of the FIC, except as indicated in subsection B, below. It should be noted that, pursuant to the Mexican Constitution and the FIL, foreign investment may not participate directly in activities still reserved exclusively to the Mexican state or to Mexicans, while some other economic activities are partially restricted to foreign capital (i.e., a maximum foreign participation of forty-nine percent, forty percent, or less without the possibility of exception) as above-mentioned. In certain cases indirect participation in such other economic activities may be allowed through Mexican trusts.

B. Use of Article Five of the FIL Regulations

Article Five of the FIL Regulations provides a way for foreign investors to exceed forty-nine percent participation in certain eligible Mexican companies,[6] *upon incorporation thereof*, without the need to obtain spe-

6. Eligible Mexican companies are those which are not to be engaged in activities contemplated

cific authorization from the FIC. Pursuant to Article Five, foreign investors are authorized to participate in up to 100% of the capital stock of such eligible Mexican companies if six basic conditions are met.

First, the foreigners must invest in fixed assets to be used to carry out the activities of the company during its pre-operating period, up to the amount established by the Ministry of Commerce and Industrial Promotion, la Secretariat de Comercio y Fomento Industrial ("SECOFI").[7] Second, the investments referred to in the first condition must be made with resources from abroad obtained either through capital contributions of the corresponding partners or shareholders, or through loans funded from abroad by foreign legal entities or credit institutions. If the partners or shareholders of the company are foreign investors already established in Mexico, they may invest resources generated in Mexico by them.[8] At the end of the pre-operating period, the paid-in capital of the corresponding company must be at least equal to twenty percent of the aggregate investment in fixed assets. Third, the company must locate any industrial facilities needed to carry on its industrial or manufacturing activities outside of the growth-controlled geographical zones[9] having the highest industrial concentration, as defined by applicable administrative provisions. Fourth, the company must at least break even in its aggregate foreign exchange balance of payments during the first three years of operation.[10] It should be noted, however, that SECOFI has the authority to waive this condition. Fifth, the company must create permanent jobs and implement continued training, education, teaching and personnel development programs for its workers, pursuant to applicable laws. Finally, the company must use proper technology and abide by environmental provisions.

Foreign investors shall be regarded as having accepted these six conditions by their subscription of shares or acquisition of quotas in the corresponding company, incorporated pursuant to Article Five. The 1989 Regulations also provide that no authorization is required for foreign investors to acquire equity of companies—whether existing or upon incorporation—which carry out in-bond activities (*maquiladoras*) or other industrial or commercial activities for export purposes.

C. Perspectives on Future Legislation Regarding Foreign Investments

The regulation of foreign investment in Mexico under NAFTA would require even greater liberalization than that provided by 1989 Regulations of the FIL. As negotiated, when and if NAFTA becomes effective,

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in the "Specific and General Regulation for Direct Foreign Investment Based on the Mexican Classification of Economic Activities and Products," attached to the 1989 Regulations of the FIL.

7. This amount is currently a maximum amount of approximately $80,000,000 (U.S.).

8. In this regard, foreign investors may carry out the investments in fixed assets referred to in the first condition pursuant to the reimbursement of dividends or retained earnings.

9. Growth-controlled geographical zones include the Federal District, the fifty-three municipalities of the State of Mexico, and the cities of Guadalajara and Monterrey.

10. The company shall be deemed to have commenced operations on the date on which it first earns income from the commercial sale of its products or from the rendering of its services.

Americans and Canadians will enjoy "national" and "most favored nation" treatment with regard to their investments in Mexico.[11] Thus, under NAFTA, Canada and the United States would qualify for a much larger investment opening for their respective nationals than those of other countries.

If the Mexican legal framework applicable to foreign investment remains as it is now, however, this scenario, albeit possible, would be extremely restrictive for Mexico. In the long term, moreover, this scenario would be detrimental to the other two NAFTA countries, as well. In order to attain growth and to maintain current economic policies and trade levels, Mexico needs to attract foreign investment from more countries than those included in NAFTA. NAFTA, however, might serve as a bar to this foreign investment, causing a corresponding decrease in Mexico's ability to provide a healthy economic environment to Canada and the United States. If Mexico's growth is stalemated or obstructed by the lack of liberalization of its regulation of foreign investment, the improvement of the purchasing power of its consumers may be delayed and/or restricted, and its foreign exchange attraction damaged, both of which would impact negatively on Mexico's current trade levels and policy.

To avoid these ill results, Mexico's opening to foreign investment will have to be directed to attracting foreign investors worldwide. To do this, Mexico must deregulate foreign investment for all nationalities, make Mexico more competitive in attracting all foreign investment, and modernize and adapt its legal system accordingly.

III. NAFTA INVESTMENT RULES

A. *Coverage*

The Investment Chapter of NAFTA covers all areas of investment not addressed in its other chapters.[12] In addition, the Investment Chapter defines investment very broadly to assure favorable treatment for most related activities. The provisions of the Investment Chapter cover not only investors from NAFTA countries, but also investors with substantial business activities in the NAFTA countries.

When NAFTA enters into effect, Canada will only be able to screen acquisitions with a value in excess of $150,000,000 (U.S.). Mexico, on the other hand, will be able to screen acquisitions in excess of $25,000,000. The Mexican threshold, however, will phase up to $150,000,000 over ten years. All threshold levels will be indexed for inflation. Investments that surpass these thresholds, however, will be subject to NAFTA's ban on performance requirements.

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11. Exceptions to this would include constitutionally restricted activities and the sectorial limits to foreign investment set forth within NAFTA itself.

12. NAFTA, *supra* note 2, art. 1101.

B. Non-Discriminatory and Minimum Standards of Treatment

NAFTA requires the application of national treatment or most favored nation status, whichever is better, to investors from the NAFTA countries.[13] This treatment extends to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments covered by NAFTA. Additionally, NAFTA countries expressly agree not to impose limitations on the share of equity that an investor from another NAFTA country may own, or to require divestment by reason of nationality of an investor from a NAFTA country.

The NAFTA provisions on treatment of investors are very liberal. For example, NAFTA requires that the parties accord full protection, security, and fair and equitable treatment to investors of NAFTA countries, regardless of whether the corresponding domestic investors receive such treatment. Similarly, NAFTA requires the state, provincial, and local governments to treat investors from another NAFTA country at least as favorably as they treat domestic investors.

With regard to government procurement, the Investment Chapter bars discrimination on the basis of ownership of capital stock, although discrimination on the basis of origin of goods is allowed. Finally, discriminatory wage and price controls will be prevented by the provisions assuring national treatment and most favored nation status.

C. Performance Requirements

NAFTA establishes a list of performance requirements that may not be imposed as a condition of investment.[14] The list includes mandatory exports of a given level or percentage of goods or services produced; minimum domestic content; preferences for domestic sourcing; restrictions on the value of imports relative to the value of exports or foreign exchange inflows associated with the investment; restrictions of domestic sales by relating them to a level of exports or foreign exchange earnings; and transfers of technology, production processes, or other proprietary knowledge, except as imposed by a court or administrative tribunal.

Elimination of these performance requirements applies to nonsignatory investors as well. Thus, Mexico and Canada no longer can require any investor to export to the United States, to limit imports of components from the U.S., or to buy components from a domestically-owned supplier instead of a U.S.-owned firm.

NAFTA permits the signing countries to condition the receipt of investment incentives on the location of production facilities, employment, employee training, or expansion of facilities in the territory of the offering NAFTA country. In addition, the provisions on performance requirements do not apply to government procurement, export promotion, or foreign aid activities.

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13. *Id.* arts. 1102-05.
14. *Id.* art. 1106.

D. *Transfers*

NAFTA prohibits restrictions on transfers and international payments, including profits, dividends, interest, capital gains, royalties, fees, returns in kind, and other amounts derived from an investment.[15] NAFTA also prohibits restrictions on transfer of proceeds from the sale or liquidation of all or any part of an investment, payments under a contract entered into by an investor or investment, compensation, and payments arising out of an investment dispute.

NAFTA requires that each signing country ensure that foreign currency may be freely transferred at a market rate of exchange. To avoid potential problems to Mexico, a qualification has been added allowing a NAFTA country to adopt restrictions in the event of a serious balance of payments situation. Such restrictions, however, must be temporary, must be approved by the International Monetary Fund, and must be no greater than necessary.

E. *Expropriation*

NAFTA prohibits direct or indirect expropriation or nationalization of investment except when it occurs for a public purpose and on a non-discriminatory basis, when it occurs upon payment of prompt, adequate, and effective compensation at fair market value (plus any applicable interest), and when it occurs in accordance with due process of law and general principles of international law.[16] NAFTA also provides an avenue for investors to challenge taxes that approach the level of de facto expropriation.

Further, NAFTA removes the previous impediments to the eligibility of Mexico for the insurance and finance programs offered by the Overseas Private Investment Corporation. NAFTA also provides that none of its provisions should be construed to affect conventions on the avoidance of double taxation. It is the understanding that cross-border withholding of taxes is being addressed in separate bilateral tax treaties among the signing countries. NAFTA does not address private commercial practices.

F. *Dispute Settlement*

The Investment Chapter of NAFTA contains its own dispute resolution system, which provides for remedies of monetary damages or, where appropriate, restitution of property.[17] In a dispute between an investor and a NAFTA country, the parties are required first to seek resolution through consultation and negotiation. If settlement cannot be reached, the investor may choose as a forum for resolution either the host country's national courts/administrative tribunals or international arbitration. Once made, the choice is irrevocable.

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15. *Id.* art. 1109.
16. *Id.* art. 1110.
17. *Id.* arts. 1115-38.

G. Country-Specific Commitments and Exceptions

All three NAFTA countries have reserved the right to screen investments for national security considerations. As mentioned previously, Canada and Mexico have also reserved the right to screen foreign investment above certain financial thresholds. In addition, each NAFTA country reserves some areas from application of the provisions of the Investment Chapter, such as energy as required by the Mexican Constitution, and cultural rights as provided for in the U.S.-Canada Free Trade Agreement.[18]

The NAFTA countries have agreed to attach annexes to NAFTA within two years, listing all state or provincial reservations as well as areas of the energy sector that are covered by the Mexican Constitution. There are two categories of reservations. The first category includes the sectors in which the parties may preserve existing restrictions but commit that they will not increase them. The second includes the sectors in which the parties reserve the right to strengthen as well as to maintain existing restrictions. It is agreed that the bulk of the reservations are in the first category. The only sectors in the second category are basic telecommunications, maritime services, and certain social service areas.

H. Investment and the Environment

There is no doubt that the environmental regulations that will be put into effect with the ratification of NAFTA will impact investment in Mexico. Consequently, Mexico is fully aware of, and is preparing itself for, the implementation and enforcement of the stringent environmental standards under NAFTA.

IV. CONCLUSION

In conclusion, Mexico's attractiveness to foreign investors in general has been greatly improved by the liberalizing 1989 FIL Regulations, while its attractiveness to American and Canadian investors in particular should improve even more with the ratification of NAFTA.

This is not to say that Mexico does not have its share of economic problems. For example, the political stability of Mexico continues to be a subject of concern. Political stability for Mexico will follow economic stability. Positive signs, however, that stability is being reached can be seen in the strides that have been made to permit greater access to political parties and to elections.

Deregulation of industry is another important economic issue, and one that is currently being addressed. In order to bring down costs and allow for a more competitive environment, the Mexican government's efforts to deregulate, as spearheaded by SECOFI, will continue and will be

18. Jan. 2, 1988, U.S.-Can., ch. 20, *reprinted in* BASIC DOCUMENTS OF INTERNATIONAL ECONOMIC LAW 353 (Stephen Zamora & Ronald A. Brand eds., 1990).

increased in coverage and depth. Examples of deregulation are found in land transportation and electric energy generation and supply, now open to Mexican and foreign investors. Other restricted areas of investment, such as railroads, and other state-controlled activities in the energy sector, are expected to be deregulated in the near future, possibly even before the entering into effect of NAFTA.

Mexico's tax system also continues to be a matter of concern to both national and foreign investors. The Mexican tax system has gone through a massive adjustment and revision in the last few years, and will continue to be adjusted and revised in order to adapt it to the economic impact of NAFTA.

There are important efforts being carried out on the part of investors at large in order to make Mexico more competitive through GATT/NAFTA-consistent incentives. Such incentives may be offered by Mexico in the future to attract investment and to allow Mexico to be more competitive with other countries of the world with similar economic conditions.

A NEW ERA: DEREGULATION OF THE TRANSFER OF TECHNOLOGY IN MEXICO

CARLOS DE LA GARZA SANTOS*

The transfer of technology law of Mexico was recently abrogated by one of the sections of the new industrial property law published in the official Federal Gazette on June 27, 1991. In order to understand the effects of this action, I want to give you an idea of the previous legal regime governing the transfer of technology in Mexico. There used to be both a Transfer of Technology Law[1] and an Industrial Property Law.[2] Now there is only an Industrial Property Law.

The abrogated transfer of technology law was effective for a period of almost twenty years. The law provided that certain agreements are subject to the approval of a governmental entity called the National Registry of Transfer of Technology.[3] The agreements subject to registration included licensing agreements, contracts for the sale or transfer of patents or trademarks, technical assistance agreements, and franchise agreements. The law provided that those agreements which were not registered were null and void and, thus, not enforceable before the Mexican courts. Therefore, royalty payments made under these agreements were not deductible for tax purposes.

The law also provided a list of clauses which, if included in the agreement, provided a basis for the National Registry to reject the registration of the agreement. This list included clauses pertaining to: provisions for tying arrangements (obligations to purchase certain equipment from the supplier as a condition for the transfer of the technology); excessive royalty payments; confidentiality obligations for a period in excess of ten years; and provisions for new developments in technology.[4]

The regulations did provide some exceptions. For instance, a grant-back provision was excepted depending on the degree of the exclusivity of payments and territory.[5] A tying clause was excepted if a particular kind of equipment was essential to assure the quality of the product.[6] Yet, all of these exceptions, although stated in the regulations, were subject to the discretionary power of the registry. The law took a very paternalistic approach. In fact, a Mexican might improve his leverage in

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* Partner, Santos-Elizondo-Garcia-Gonzalez-de la Garza, S.C.; Garza Garcia, Monterrey, N.L.; Professor of Law, University of Monterrey, 1984-88; Legal Director, Corporate Matters, Grupo Industrial Alfa, S.A.; Lic. en Derecho, University of Monterrey; Master Comp. Law, Georgetown University; Doctor of Jurid. Sci., University of Paris; admitted to Mexican bar (1975).

1. DIARIO OFICIAL DE LA FEDERACIÓN, Dec. 29, 1981 [hereinafter Transfer of Technology Law].
2. DIARIO OFICIAL DE LA FEDERACIÓN, Feb. 10, 1926.
3. Transfer of Techolology Law, *supra* note 1, § 2.
4. *Id.* § 15.
5. Regulation of the Transfer of Techology Law, § 35, *published in* DIARIO OFICIAL DE LA FEDERACIÓN, Jan. 9, 1990.
6. *Id.* § 38.

negotiating contracts by using the excuse that the law did not allow the inclusion of certain clauses or that payments required for the technology were too high; therefore, the agreement would not be approved.

Some of the provisions prohibited in the abrogated law are similar, if not the same, to some practices that the U.S. courts have considered illegal under the Sherman Act[7] and the Clayton Act.[8] In some of these cases, the rule of reason does not apply and the clauses are considered as per se illegal, as is the case with the certain tying provisions and grant-backs. In the United States, the criteria used to determine whether or not certain clauses are restrictive or unfair has been developed by judicial precedents based on interpretations of the provisions of the Sherman and Clayton Acts. Now that the transfer of technology law has been abrogated in Mexico, one could question whether the transfer of technology is regulated by any rules at all.

There are certain provisions of the Industrial Property Law that it would be appropriate to analyze. Article 62 of the new Industrial Property Law provides that patent rights may be transferred totally or partially, subject to the formalities of the Code of Commerce. Article 66 of the new Industrial Property Law provides that a license of a patent will not be registered for the purpose of enforceability against third parties, if the license is granted for a time in excess of the effectiveness of the patent or if the agreement is subject to a foreign law. Article 143 provides that trademark rights may be transferred under the terms and the formalities of the Code of Commerce, but that for purposes of enforceability against third parties a license of a trademark must be registered. This will not be so if the license is subject to a foreign law or for appropriate reasons of public interest as provided in the regulations, which as of today have not been enacted. It is important to emphasize that such provisions apply only for purposes of effects upon third parties. In principle, one could say that the transfer of technology in Mexico is governed by the principle of freedom of contract.

There is an old monopoly law in Mexico, enacted August 31, 1934, which is interesting to analyze.[9] Under Article 1 of the Anti-Monopoly Law and according to Article 28 of the Constitution, the existence of a monopoly is forbidden, as well as all acts that tend to prevent the free production, distribution, or trade of goods. Agreements or combinations by producers, industry merchants, or entrepreneurs to prevent competition among themselves or to displace third parties from the market or to impose prices on goods or fees on services in an arbitrary manner also are forbidden. Article 5 of the Anti-Monopoly Law provides that it would be presumed as intending to monopolize or attending against freedom of concurrence. Article 7 covers engaging in contracts, agreements, or

7. 15 U.S.C. §§ 1-7 (1988).
8. *Id.* §§ 12-27.
9. DIARIO OFICIAL DE LA FEDERACIÓN, Aug. 31, 1934.

combinations that have the purpose of establishing an exclusive or undue advantage in favor of one or several determined persons.

These provisions are, in principle, similar to what the United States has in the Sherman and Clayton Acts. Has Mexico construed the anti-monopoly law? Do we have the same judicial precedents as in the United States? Is it applicable to those transactions? Unfortunately, Mexico does not have the large number of cases that the United States has nor does Mexico have the principles that have developed out of such law. Thus, if one uses the anti-monopoly laws as an argument against the use of a particular clause, what criteria would be applied in Mexico? Will the same criteria be considered by the judges as in the United States?

Most likely, Mexican officials, because of the belief that internationalization or modernization means to abolish restrictions, will conclude that the abrogation of the technology transfer law was intended to free, legalize, or liberalize these types of transactions. As a result, the law leaves a high degree of uncertainty.

Mexico can and should benefit from the experience abroad and establish rules based on international standards. The Mexican Congress should modify the anti-monopoly law, or include a chapter in the industrial property law, so that some clauses relating to the transfer of technology would not be enforceable because of the general principles adopted by U.S. courts, which have found that such clauses are illegal per se.

COMMENTS ON THE CURRENT STATUS OF INTELLECTUAL AND INDUSTRIAL PROPERTY REGULATION IN MEXICO

SEAN McMILLAN*

A new technology law in Mexico was adopted in mid-1991.[1] It is a major step in the protection of technology, particularly from the standpoint of the United States. There has been a strong effort on behalf of the United States government to get many countries to adopt stronger laws to protect technology and other intellectual property, such as patents, copyrights, trademarks, know-how, and sound and visual recordings.

I am going to focus on the things that the North American Free Trade Agreement ("NAFTA")[2] will require in the context of required changes to the 1991 Law. The new law was principally motivated by pressures related to the then on-going NAFTA negotiations and by the United States's threat of imposing rather strict penalties under Super 301.[3] Billions of dollars are lost each year by people misappropriating other peoples' intellectual property. The climate in Mexico has changed dramatically. The standards today in Mexico are at or near par with most other industrial nations, at least with respect to an in-place legal regime. Yet, there still exist issues of enforcement and whether people will actually abide by the law.

A basic premise of NAFTA is that of national treatment. NAFTA imposes an obligation that Canadian and American companies and individuals will be afforded by Mexico the same treatment and rights to intellectual property as Mexican nationals. Similarly, the United States and Canada must provide Mexican nationals the same rights they provide their own nationals. Copyright law is covered by a separate law, and NAFTA generally makes a number of changes in that area.

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* Partner, Bryan Cave, Santa Monica, California; Author, *Practicing Transnational Law: The Nature of the Business Opportunities and the Relevance of Contemporary Legal Education, in* PROCEEDINGS OF THE AMERICAN SOCIETY OF INTERNATIONAL LAW 245 (1973); Vice Chairman, ABA Section of International Law, 1979-81; Diploma, University of Munich; Certificate, International School of Copenhagen; S.B., University of Southern Calif.; J.D., Harvard Law School; admitted to bar of California (1971).

1. The Law for the Fostering and Protection of Industrial Property (*Ley de Fomento y Protección de la Propiedad Industrial*) was passed by the Mexican Senate on May 16, 1991, by the Chamber of Deputies on June 25, 1991, and was published in the *Diario Oficial* on June 27, 1991 [hereinafter 1991 Law].

2. Oct. 7, 1992 draft, U.S.-Can.-Mex. [hereinafter NAFTA].

3. 19 U.S.C. § 2420 (Supp. 1993). In May 1989, the U.S. government placed Mexico, along with seven other countries, on a "priority watch" list under the "special 301" provision of the Omnibus Trade and Competitiveness Act of 1988, for its failure to protect intellectual property rights. In January 1990, Mexico was removed from this list in response to the Mexican government's commitment to pass effective intellectual property rights legislation.

Many of my clients happen to be in the electronics/computer (hardware and software) and medical industries and were not adequately protected in Mexico prior to the 1991 Law.[4] Doing business in Mexico in a technology-based industry was very difficult before 1991 and, as a result, Mexico did not get the latest and best technology because companies were afraid of it being lost. The new law changes much of that and NAFTA takes it even further.

In the area of industrial property, NAFTA provides that all parties will adhere, at a minimum, to the following major treaties: the Geneva Convention (on phonograms); the Berne Convention (copyrights); and the Paris Convention (industrial property).

Attorneys and others from common law countries need to be aware that injunctive relief is not available under the Mexican legal system. The only remedies for a breach of the 1991 Law or the implementing laws, required by NAFTA, will be an action for damages or administrative or criminal proceedings. If you are the complaining party, you will have little or no control over such proceedings except to initiate them.

Within NAFTA there is a special provision on control of abusive or anti-competitive practices.[5] It is basically the right of the state to adopt appropriate measures to prevent such practices. What those are, we do not know, but they will be the likely subject of regulation. Such issues are generally handled administratively in Mexico rather than by private litigants as in the United States.

Agreements involving technology transfer are likely to be dealt with in Mexico similarly to how such agreements are dealt with in Europe. The European Community has a well-developed system of block exemptions. If you license industrial property in Mexico along the same lines as you would in Europe, you should be reasonably protected.

A. Patents

Under the 1991 Law, Mexico greatly expanded those things that could be patented but still prohibited patenting inventions in certain categories including: surgical, therapeutic, and diagnostic methods of treatment; plant and animal species (other than microorganisms); and certain biological processes which under NAFTA can continue to be excluded from patentability.[6] Mexico's 1991 Law prohibited patents in other areas, but under NAFTA, Mexico will only be able to exclude from its patent system those other inventions which Mexico concludes are *not* appropriate for exploitation in Mexico.[7]

During the NAFTA negotiations, Mexico insisted (under an "exhaustion of rights" doctrine) that once goods were placed in the stream of commerce in any country, the importation of such goods from such country into

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4. *Ley Sobre el Control y Registro de la Transferencia de Tecnologia y el Uso y Explotacion de Patents y Marcas*, DIARIO OFICIAL, Jan. 11, 1992.
5. NAFTA, *supra* note 2, art. 1704.
6. 1991 Law, *supra* note 1, arts. 19 & 20.
7. NAFTA, *supra* note 2, art. 1709.

a signatory country could not be prohibited even if valid intellectual property rights existed (e.g., a patent, trademark, or copyright) with respect to those goods in each country. Under NAFTA, it is not clear that an exclusive distribution of goods (protected by a patent, trademark, or copyright in that country) will be able to prohibit the importation of "gray" goods (i.e., goods legally manufactured and sold in one country but which were not intended to be exported outside that country).

B. Copyrights

NAFTA will require Mexico to expand its copyright law and protections substantially. A new concept to Americans is that of moral rights, or the rights of an author, which is expressly permitted and identified in NAFTA[8] as well as the Berne Convention.[9] In addition, under NAFTA the copyright holder will be able to control who may import or export a copyrighted work. Computer programs are to be protected under the copyright provisions. Copyrights cover other significant areas such as movies, tapes, musicals, video games, phonograms, and books. Mexico has had a long history of reproducing copyrighted works without proper authority to do so. Notably, there appears to be a reduction in Mexico in the past year or so in violations of copyrights, particularly in the areas of sound recordings and video cassettes. Nevertheless, one can still go into certain cities in Mexico and get first-run movies on video cassette.

C. Trademarks

Mexico's trademark law is consistent, I think, with NAFTA. Major changes have been made in the trademark area under the 1991 Law. At one time, you had to use a Mexican trademark with your United States or foreign trademark. This is no longer required. The type of protection you get for your trademarks has been significantly improved. No material changes should be expected as a result of NAFTA.

D. Compulsory Licensing

This is a foreign concept to most American lawyers and business people. Compulsory licensing will still exist, particularly with respect to patented drugs. At one time, Mexico would not allow a company to patent pharmaceutical products. It is a very expensive process to develop drugs. The companies are very jealous in protecting their products. By 1997, the full range of pharmaceutical products will be patentable.[10]

E. Semi-Conductors

Under NAFTA, Mexico will be required to protect layout designs (topographies) of electronic integrated circuits. In effect, Mexico will need

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8. *Id.* art. 1705.

9. Berne Convention for the Protection of Literary and Artistic Works, July 24, 1971, art. 6(b) (Paris Revisions). Moral rights include *paternity* (require attribution), *integrity* (prohibit changes), *publication* (right to determine first publication), *et cetera*.

10. NAFTA, *supra* note 2, art. 1709(4).

to adopt a law which prohibits the unauthorized importation or sale of an unlawfully reproduced layout design as it has no law protecting this form of industrial property.

F. Trade Secrets

Major changes were made in the 1991 Law to protect trade secrets. The effect of prior law was that trade secrets could not be protected beyond a limited period of time (usually five years). Thus, anyone who had been provided with your trade secrets could use them without compensation at the end of that term. Under NAFTA and the 1991 Law, covenants not to use or disclose confidential information will be enforceable so long as the information remains non-public (at least to the extent of damages for a breach of that covenant). But again, it must be remembered that there is no injunctive relief in Mexico under their civil law system, so you will need to go to the Ministry of Commerce and Industrial Promotion, la Secretariat de Comercio y Fomento Industrial ("SECOFI") or another administrative body and ask them to help you prevent misuse of your patents, trademarks, and know-how.

G. Appellations of Origin

NAFTA's provisions relating to geographical indications (or appellations of origin) of goods (e.g., champagne) are permissive rather than mandatory. These provisions are primarily exceptions which permit a country, under certain conditions, not to register appellations of origin. The 1991 Law[11] permits registration of geographical indications ("denominations of origin") and their use, provided that they are not misleading and that they reflect that the quality or characteristic of a product is attributable to the geographic origin of the goods (both natural and human factors being considered).

H. Industrial Designs and Utility Models

These are subject to special patents and are covered under the 1991 Law.

11. 1991 Law, *supra* note 1, tit. 5, arts. 156-78.

DISCUSSION OF MEXICAN INVESTMENT LAW AND REGULATIONS

QUESTION: Do North American Free Trade Agreement ("NAFTA")[1] provisions supersede Mexican law in the event of inconsistency? That is, to what extent will NAFTA supersede Mexico's Foreign Investment Law?

ANSWER, *Lic. Jauregui*: That involves a conflict of law problem. Mexico should deal with this in a practical manner. Mexico has always adopted the implementing legislation of a future treaty prior to adoption of the treaty. In other words, it has always avoided embarrassment in the legal system by adopting the legislation prior to adopting the treaty. Our lives are not going to be any different. We started with the Intellectual Property Law. We are going to adopt the new Foreign Investment Law before the ratification of the treaty by us or the approval of NAFTA by you.

ANSWER, *Mr. Stephenson*: Generally speaking, NAFTA is a non-self-executing treaty. Therefore it requires implementing legislation by all of the countries to the extent that they have inconsistent laws that do not now provide or cover NAFTA provisions.

QUESTION: Please predict to the best of your ability the time frame for the development and enactment of most favored nation investment laws in Mexico. Will they be phased in or be part of a single NAFTA implementation legislation package?

ANSWER, *Lic. Jauregui*: I think that they will be part of the NAFTA implementation package.

QUESTION: Will Mexico require a California type registration of its franchises under the Industrial Property Law?[2] And when will regulations implementing the new franchise arrangements be set out?

ANSWER, *Lic. de la Garza*: First, I do not know what California does, but I can tell you that because the term "franchise" includes a license of a trademark, you have to register for purposes of enforceability against third parties. As I mentioned, registration may be rejected if a foreign law governs the franchise or for "reasons of public interest," as provided in the regulations. The regulations have not been enacted and, therefore, I do not know what "reasons of public interest" are.

QUESTION: Does anyone know what "inscription" means as it is used in the Industrial Property Law?

1. Oct. 7, 1992 draft, U.S.-Can.-Mex. [hereinafter NAFTA].
2. Diario Oficial de la Federación, June 27, 1991.

ANSWER, *Lic. de la Garza*: You simply present a copy of the trademark license agreement or the patent license agreement for registration purposes, but not to pass judgment on the contents. It is just to know which patent or which trademark has been licensed. I think it is a regulatory requirement to obtain statistical data more than anything else.

ANSWER, *Mr. McMillan*: The big difference between Mexico and the United States is that you do not have to register any of your license agreements in the United States. For enforceability purposes, it is helpful to have copyrights and trademarks registered. In Mexico, I believe that to enforce or to obtain administrative assistance in enforcing rights to trademarks, patents, and copyrights, they must be registered and that may be what the inscription means. But there is now no longer an administrative review of the terms and conditions upon which you are permitted to license somebody to use those marks, patents, or copyrights.

QUESTION: The NAFTA provisions require each party to provide methods to prevent the illegal use of intellectual property rights.[3] Assume SECOFI or the responsible administrative agency fails to enforce patent protection rights in Mexico; would a Writ of Amparo lie to require them to enforce the law?

ANSWER, *Lic. de la Garza*: Yes. Not only that, but you will have a criminal action now under the new Industrial Property Law.

ANSWER, *Mr. McMillan*: You also have a civil action for damages. You can make a claim to SECOFI to bring an administrative action. SECOFI is required within so many days to initiate an investigation. There are penalties involved with that. They can also bring criminal actions. In NAFTA, there also is some discussion on whether or not one may exclude products crossing the border if they contain an offending trademark and copyright or patent. That is new for Mexico.

QUESTION: With respect to the possible competition law, has not the privatization of state enterprises in Mexico led to an increased oligopoly power in the private sector?

ANSWER, *Lic. Jauregui*: The Mexican private sector has been very nationalistic. I do not want to call it greedy because I don't think that is true. The private sector brought a lot of money back to Mexico. Up to now, foreign investors have unfortunately not been as keen to act as the Mexican private sector. It is really up to the Mexicans to bring back our money, to put our money where our country is and where our resources are. But there will be a redistribution of the ownership of privatized companies, as the requirements for cutting edge technology, for capital, and for expansion become a reality, and because of strategic alliances with the European Community, the Pacific Rim, and North

3. *See generally* NAFTA, *supra* note 1, ch. 17.

America. Any present concentration of ownership in a few Mexican groups is a transitory phenomenon that is perfectly explainable to the world.

QUESTION: Will NAFTA require Mexico to relax its restrictions on foreign ownership of real property in Mexico?

ANSWER, *Lic. Jauregui*: Mexico has started that in the regulations of 1989, through the liberalization of trusts in the restricted zone, and through the liberalization of direct purchases. The Mexican real estate market seems to be a very attractive area to foreign investors, and we see a lot of activity for traditional investors in pension funds and in very active futures markets.

QUESTION: How effective do you expect the Industrial Property Law to be in preventing the counterfeiting of products covered by trademarks and tradenames that are registered in Mexico?

ANSWER, *Mr. McMillan*: Mexico has never been an outrageous place for counterfeiting of goods or copying someone else's goods and putting the trademarks on it when you do not have the right to do so. This has occurred in the garment industry, but most of these products have been excluded when they came back into the United States. So I do not think it has been a significant problem. There has not been the commercial large-scale counterfeiting in Mexico as in many countries of Asia. One exception is not really counterfeiting, but in the video cassette and music sound recording areas. There are special provisions in NAFTA for sound recordings.[4] There is also an exemption under NAFTA for the Canadians, giving some benefits to "national cultures."[5] That allows a party to give preference to nationals of one country for certain specific things where cultural matters are at issue, as in Quebec. How Mexico will use that is unclear.

QUESTION: The 1989 Foreign Investment Regulations imposed balance of payments requirements on 100% foreign-owned corporations. Do the NAFTA transfer provisions automatically eliminate this requirement? If so, when?

ANSWER, *Lic. Jauregui*: These requirements will be gone as a practical matter. That is why I said that the Mexican Foreign Investment authorities have been extraordinarily receptive and intelligent in applying the regulation. If you have a problem with your balance of payments, they postpone that year's deficit or crisis to the following year. They see to it that you comply, but they are friendly, understanding, and will accommodate you. The requirement standards will be gone completely with

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4. NAFTA, *supra* note 1, art. 1706.
5. *Id.* annex I (C-1 Schedule of Canada).

NAFTA, but they may be gone even before that. They may be gone before the end of 1992 if the new Foreign Investment Law becomes a reality.

QUESTION: For those companies that have existing contracts with Mexico for both capital investments, export requirements, and hiring and training, do you know whether or not those will be done away with? If I promised last year to do a whole bunch of things over the next three years, what will be the impact of NAFTA or the new Foreign Investment Law? Will these undertakings be wiped out in effect?

ANSWER, *Lic. Jauregui*: I will use precedent to answer that. In the prior regulations and the application of the prior Foreign Investment Law, there were very stringent programs enacted to allow 100% ownership or to allow an expansion of an activity or a line of products. The moment that the regulations of 1989 came into effect, these were done away with. I assume that those conditions imposed under Article 5, or those conditions that have been imposed if you are already established in Mexico, will be done away with completely. Retroactivity is always in favor of the people under the jurisdiction of Mexican law.