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Panel Discussion: Financing Mexican Infrastructure Development

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PANEL DISCUSSION: FINANCING MEXICAN INFRASTRUCTURE DEVELOPMENT

MODERATOR: JOHN STEPHENSON, ESQ*

PANELISTS: LIC. MIGUEL JÁUREGUI ROJAS, CARLOS MALPICA HERNÁNDEZ, CAROL MATES, GERARDO FREIRE ALVARADO AND IÑIGO DE LA BORBOLLA

JOHN ROGERS: It seems to me there is some contradiction in the concept of the guarantee trust because if the idea is to transfer a portion or all of a debtor’s assets to the guarantee trust to guarantee the debtor’s obligations, how does that avoid automatically putting the debtor into a state of insolvency?

MIGUEL JÁUREGUI ROJAS: First, if we were talking in the context of the old guarantee trust, I think that this would be the case and that is why it never worked. If you were going to set up a guarantee trust, you would have to obtain all of the assets of the borrower to guarantee it. All of the assets had to be obtained under the old guarantee trust in order to provide further recourse against the debtor. So, since you needed to have all of the debtor’s assets, it is likely that the debtor would face insolvency. That is why the old vehicle never worked.

The new vehicle is different because it is not all encompassing and you have the right to go to the debtor for more if what is originally secured is not sufficient. The real issue is to keep the new guarantee trust as amended, because it works by leaving some of the debtor’s property free to guarantee other debts or to have cash available. Ultimately the old trust was the equivalent of pre-pack in an insolvency procedure; basically all of the debtor’s assets were tied up and the debt was pre-packed. With the old trust if the debtor goes insolvent, the debtor’s assets are lost to the creditor.

OCTAVIO CARAVAJAL: This question is for Carol Mates. When you are evaluating the environmental viability of a project for which financing has been requested, how satisfied is the International Finance Corporation (IFC) with the Mexican environmental laws and regulations, or do you point out other certificates to be accomplished or gained by those companies in order to evaluate that there is an environmental possibility in those projects?

CAROL MATES: The answer really is a technical one depending on how Mexican law comports with World Bank Group environmental standards and environmental and social policies. The World Bank Group now has a complete set of environmental standards and guidelines for the particular enterprises, and in some areas that IFC finances and the World Bank does not, IFC has its own

* The views expressed herein are those of the panelists, and should not be taken to represent the views of their employers or other organizations with which they may be affiliated.
** A summary of the panelists’ background appears on the last page of the panel discussion.
1. John Rogers is a partner in the firm of Strasburger & Price, S.C. in Mexico City.
2. A pre-pack is a chapter 11 bankruptcy case that the parties have already worked out.
3. Octavio Caravajal is a partner in the firm of Vera, Caravajal & Sosa S.C. in Mexico City.
standards. IFC's environmental specialists will assure that the project meets the World Bank Group's environmental standards. So in any particular country, they will look at the specific sector and local requirements. In some cases the local requirements are more stringent than the World Bank requirements, and whether the project is a new project or an existing project, it will be required to meet the higher of the World Bank standards or local standards. In other places, the local law is not up to the World Bank standards, and so they will have to meet the World Bank standards. Legally what they will do is say, "You have to meet the World Bank standards," but in the loan documentation it will also say that you have to comply with all the laws, including environmental laws.

I once worked on a drinking water project where the host country had terrific standards that were higher than the standards set forth by the World Bank. The IFC was not sure if the project could comport with the local legislation because of its stringent requirements. Each case really is specifically analyzed and categorized A, B or C, and IFC has specific rules.  

JAIME CORTÉS: I also have a question for Carol Mates. Can the credit enhancement scheme of the Tlalnepantla water project be repeated in a private project such as a bond issue for housing projects?

MATES: Yes, in principle it could be, so long as all other IFC policy and financial requirements were met.

MICHAEL OWEN: This question is for Carol Mates. You mentioned during your presentation that IFC rules indicate that the IFC has to be a passive investor and cannot take a management control position. I am wondering, in a situation where you are in a workout, are you able to work with the other creditors if in fact the real problem is the management and you need to get rid of the management?

MATES: Yes. Once IFC deems the project to be in jeopardy the rules requiring IFC to be a "passive investor" are no longer applicable. There is a specific provision in our charter that basically says the corporation shall not be constrained by this charter restriction in a jeopardy situation, permitting it to do what it needs to in order to get its money back. So we join with other creditors to enforce our remedies as a creditor, and that is often where our ability to go to governments and engage in discussions as a quasi-diplomat can be helpful. We have had to do this in some East Asian countries in the aftermath of the financial crisis of the late 1990s. During and after the severe economic problems following the 1997 crisis, lenders went to the courts to enforce their loan instruments or mortgages. The first thing that some of the borrowers did was to try to persuade the courts to favor local

5. For further information on the IFC and the IFC's rules related to standards see the IFC's official website at http://www.ifc.org (last visited March 31, 2004).
6. Jaime Cortés is a partner in the firm of Mijares, Angoitia, Cortés y Fuentes S.C. in Mexico City.
7. Michael Owen is a partner in the firm of Paul, Hastings, Janofsky & Walker L.L.P. in Los Angeles, California.
interests over those of foreigners, sometimes successfully. IFC actually took some of the borrowers to court in those cases. We had a very long case in one East Asian country with a company that did not want to give up its assets to a foreclosure but was not paying any creditors. The company really pulled political strings to prevent the bankruptcy trustee from effectively taking over the company. This has lasted approximately two years, but we have led a creditor group. We had a similar case in at least one other East Asian country.

ROBERT BARNETT: My question is for Carlos Malpica, and it is in regard to the role of the attorney in a publicly financed transaction. In the United States and many other jurisdictions, often there will be an attorney or law firm representing the issuer, and a different attorney or law firm representing the underwriter, and we have not seen this thus far in Mexico. I wanted to get your comments on why that has not happened and if in your opinion it is possible it will happen in the future?

CARLOS MALPICA HERNÁNDEZ: During the 1980s and 1990s in the Mexican practice there used to be one lawyer for the underwriter and one lawyer for the issuer. I think that because of the cost involved one single lawyer acts for the issuer and provides a legal opinion on the transaction involved, and the underwriter has internal counsel. In my experience it is very rare to have separate lawyers for the underwriter and the issuer. In the last five years or so, I have only represented an underwriter once, which was Santander in the securitization of the payroll tax of the State of Mexico.

BARNETT: This question is for the Santander representatives. Do you see the same or similar situation as part of the fiscal reform in Mexico where public finance transactions would yield interest-free income for investors, like the tax-free transactions that you see in the United States and other countries?

GERARDO FREIRE ALVARADO: I expect that currently all the issuers, including the government, need to pay taxes. I do not think that in the years to come we will see the Mexican government change the rules regarding public finance transactions and tax exemptions.

JOHN STEPHENSON: You mentioned the restrictions on foreign investment, foreign ownership of some bonds, and then you mentioned that next year you think you are going to get a repo authorization. Can you not then buy the bonds in Mexico and resell them to foreigners or package something like that?

INIGO DE LA BORBOLLA: Basically, the restriction comes from issuance from states and municipalities. You can resell other bonds freely. It would be wonderful if we could find some legal structure in which we would be able to package bonds from the states and municipalities and sell them to other investors. At the moment, we believe that there is enough money in Mexico to finance these kinds of public

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works, and therefore we have not explored the possibility of finding some way to overturn the restriction because there has been money to finance these states and municipalities.

FREIRE: Tlalnepantla is a good example where this kind of limitation can be avoided.

DAVID SPENCER: This question is for Miguel Jáuregui. I was intrigued by the characteristic of the amendments that you mentioned whereby the parties might make their own tailor-made rules of foreclosure, including a non-judicial process, which seems like a dream come true. Has anybody done this yet as far as you know? Will there be some standardized procedures, perhaps, developed by the Mexican bar or circulated in some fashion? How do you see that developing?

JÁUREGUI: The main challenge within the Mexican legal system has been how to enforce things and how to follow a procedure before the judiciary when there are no standards of procedure, as you know them, in the Anglo-Saxon court system. The reason that the mortgage guarantee was successful for a number of years was because there were standards of procedure associated with it and people understood what the court meant and what the creditors and debtors expected. Now these instruments have their own execution processes. The public policy stated by the government when they proposed the amendments to Congress will allow for a much more agile execution and foreclosure of these instruments. Now, it is daunting at this point as to how much the Amparo resistance will be there and whether or not Mexican litigators are going to find loopholes so that automatic foreclosure cannot really be enforced. However, these amendments will prevail and resolutions from the Supreme Court or district courts will soon uphold these processes. Now the issue will be to what degree do the instruments have standards of process built into them similar to those the judiciary would want built in, so that doubt is eradicated. But it is, as you say, new and we are going to have to be sure that it works.

ROGERS: I had a question related to the constitutional restriction on foreign financing and foreign currency by states and municipalities. Looking at the structure of the Tlalnepantla project, there is, at least indirectly, a foreign component to the financing. I was wondering to what extent there was an obligation, running directly or indirectly, from the municipality to Dexia and the IFC?

MATES: There is none.

ROGERS: This question is for Carlos Malpica. What if, in a municipal financing, there is a foreign guarantee, and the financing source is originally domestic, from the Mexican capital markets or a Mexican lender, but there is a foreign entity that

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10. David Spencer is an attorney in Snohomish, Washington.
11. If a litigant has a claim based on a violation of a constitutional right, the litigant may bring an Amparo proceeding, which is an appeal to the federal tribunal. If the court finds that the rights of the litigant were violated the ruling is binding only on the litigants before the court.
is guaranteeing the debt. Does that potentially run the risk of violating the constitutional restriction if, upon payment by the guarantor, which is then subrogated to the rights of the original creditors, the obligations run directly from the municipality to a foreign creditor?

MALPICA: Yes, I think that the risk of violating the constitutional restriction would certainly exist. However, please note that there are two opinions regarding the issue. The first one is that it would be a non-direct debt to a creditor, or guarantor in this case, and therefore in breach of the constitutional restriction for states and municipalities. The second one is that if the transaction is structured through a trust without recourse to the state and/or municipality (which I understand was the case at Tlalnepantla), it would not violate the constitutional restriction.

RICHARD KRUMBEIN: Carol Mates mentioned that IFC has financed five independent power producers (IPPs) in Mexico. In the case of these IPPs, when you go through the cash-flow evaluation, are you looking both at the Power Purchase Agreements with the Comisión Federal de Electricidad (CFE) as well as the private sector? Do you have two different sources in many cases, or do you exclude CFE from the equation?

MATES: No, the IPPs IFC has done to date have all been with CFE. We are looking at some under the auto-producer scheme and are hoping that we can do something more under this scheme. We need a company that has good credit in order to finance an IPP with that company as an off-taker under the auto-producers scheme. I understand that there was a supreme court ruling within the last year or so on the whole auto-producer scheme, knocking down the regulations which would have amplified that scheme and the ability of auto-producers to sell to CFE.

DAVID HURTADO BADIOLA: This question is for Miguel Jáuregui and Carlos Malpica. I am interested in your opinions on the use of arbitration as a possible device to circumvent or avoid the judicial obstacles to enforce or foreclose this new mechanism of guarantees.

JÁUREGUI: I think that what we are debating currently is whether payment obligations can be arbitrated and whether, because of the nature of the obligation, you really need arbitration, or is it easier to go to a court of law. Whether one should arbitrate or not has been a dispute in the Mexican bar for a number of years. Members of the bar are coming to some consensus that it makes sense to arbitrate precisely to avoid certain issues, albeit if we go to arbitration we have to worry about public policy issues. There are many issues underlying the proper execution of arbitral awards that are of concern today, and so therefore, I do not know if arbitration per se is a cure-all because the judiciary, in the end, will put the force of law into it. But certainly if we were talking in the context of arbitral awards issued in international arbitration, I would feel more comfortable. Arbitral awards issued

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12. Richard Krumbein is a partner in the firm of Snell & Wilmer, L.L.P. in Denver, Colorado.
13. David Hurtado Badiola is a partner in the firm of Jáuregui Navarrete Nadar y Rojas S.C. in Mexico City.
for payment obligations in the local scenario would probably be less likely to be enforced per se in verbatim than the obligations of a foreclosure in a new instrument like the guarantee trust. This is my perception, but it is really hard to say until the judiciary acts on the issue.

MALPICA: I think Miguel explained it perfectly. The only thing that I would like to address is that in the future we are going to see fellow attorneys trying to run down and destroy that provision as unconstitutional. In the meantime I would rather recommend that my clients go through the normal litigation channels until this arbitration clause is tested.

MATES: If I can just add as a lender's counsel, I do not think lenders would want to arbitrate issues of payment or foreclosure of security in Mexico. So it may be of interest to some lenders, but I believe IFC would never accept it.

ROGERS: On this issue of enforcement, where you have a debt obligation, loan obligation, investment obligation or any such obligation, under a document in which the parties have submitted to U.S. law and jurisdiction or to Mexican law and jurisdiction, but you have a transaction secured by collateral, let us assume that the collateral protection is currently much better than it was a few years ago, a non-possessor pledge or guarantee trust, or whatever. That guarantee or collateral security enforcement, presumably, would have to be under Mexican law and Mexican jurisdiction. If the underlying debt obligation were to be enforced in the United States and then brought to Mexico for enforcement in Mexico with collateral protection, how would you see the procedure?

JÁUREGUI: First, when trying to enforce Mexican issues in a court of law other than a Mexican court of law, you would have to distinguish between real property rights and personal property rights. It is much more feasible to enforce personal property rights in a court of law other than that of a Mexican court of law. The restriction there would be that you comply with Mexican due process of law principals so that you do not end up with a perfect decree of a foreign court that cannot be enforced in Mexico because of the Amparo proceedings that we would have available as Mexicans if you did not follow due process of law.

First and foremost, notifying and serving process on the defendant in a manner other than that prescribed by Mexican law may be a nightmare for a court outside of Mexico that is trying to enforce a personal property right. So, suppose that the problem of notice and service are circumvented, and therefore it is a personal property right that we are trying to enforce in a Mexican court of law. You would go through the proceeding law and look at whether the criteria to enforce a foreign decree are met--principally, public policy. And if that is the case the decree will be enforced. Now if there is collateral that may have an in rem guarantee, we have the problem of applying Mexican law in a court of law outside of Mexico in the proceedings, and then bringing that decree back to Mexico and asking a Mexican judge to enforce the award while agreeing that that the standards of procedure of enforcement of a real property right were done properly. For example, a Uniform Commercial Code filing would not be sufficient if you do not have it coupled with a Mexican type of collateral or a guarantee that is backed up by an in rem guarantee
here, pursuant to Mexican law and enforceable in Mexico. So I do not see that a U.S. court would throw out the enforcement of the collateral with real property, necessarily. But the issue is whether the Mexican court will accept the criteria of the foreign court as to how that foreclosure should have taken place and the standards of procedure, obviously, in Mexico, vis-à-vis the standards of procedure followed in the foreign court.

This is a very difficult question you asked, and in my view probably unlikely to occur. First, if I am advising my client, I would rather have a promissory note made pursuant to Mexican terms because it is easier. Second, if I am going through the enforcement of covenants within a loan agreement, then I would probably advise my client to put that in a public instrument so that he could sue under the expedited proceedings in Mexico with the first certified copy. Lastly, if I am going to have an in rem guarantee, I would rather have a Mexican document that says Mexican law and looks to Mexican standards of procedure, because otherwise, I think I would have created, and I say this with respect, a hell of a mess for my client.

**BIOGRAPHICAL SUMMARIES**

**John M. Stephenson, Esq.** is a partner in the Business Transactions section and a member of the Energy Practice Group of Jackson Walker. Mr. Stephenson is the President and Director of the United States-Mexico Law Institute, which was established by him with the support of the ABA Section of International Law & Practice in 1992 when he was Chairman of the Mexican Law Committee of the Section. Mr. Stephenson has specialized in international business transactions and is a former Chairman of the Section of International Law of the State Bar of Texas. Before joining the firm of Jackson Walker, he was a partner of the Jenkens & Gilchrist firm in Dallas. He received his B.A. degree from Rice University and an L.L.B. degree from Southern Methodist University. He is admitted to practice before the United States Court of International Trade and the Court of Appeals for the Federal Circuit. He was admitted to the Bar of Texas in 1965.

**Carol M. Mates, Esq.** works for the International Finance Corporation (IFC) as Principal Counsel in the Legal Department. She specializes in project finance and particularly the financing of private infrastructure projects. Her work has entailed syndication of loans with banks in Asia, Europe and the United States, as well as co-financing arrangements with bilateral and other multilateral development agencies and local development banks. The views expressed are her own, and should not be construed as official views of IFC.

**Lic. Miguel Jáuregui Rojas** is a founder and member of the firm of Jáuregui, Navarrete, Nader y Rojas, Torre Arcos, Paseo de los Tamarindos 400B, Pisos 8 y 9, Col. Bosque de las Lomas, 05120 México, DF. Lic. Jáuregui's main areas of practice include mergers and acquisitions, taxation, telecommunications, energy, infrastructure and trade. He is a member of the Mexican Academy of International Law (Academia Mexicana de Derecho Internacional), the Mexican Bar Association (Barra Mexicana, Colegio de Abogados), the American Bar Association, the National Association of Corporate Counsels (Asociación Nacional de Abogados de
Lic. Carlos Malpica Hernández is a partner in the Mexico City law firm of Mijares, Angotea, Cortés y Fuentes. Lic. Malpica Hernández's practice includes corporate law, telecommunications and structured finance, mergers and acquisitions, securities and banking law. He received his Licenciatura en Derecho from the Universidad Iberoamericana in Mexico City. He studied several postgraduate courses at Notre Dame University in London and studied European Community Law at the Universidad Complutense de Madrid. For the past several years, Lic. Malpica Hernández has been an invited examiner for banking courses at the Escuela de Derecho in Mexico City. He recently published an article entitled, "Política Cambiaria y Libre Comercio, la Experiencia Europea."

Gerardo Freire Alvarado is a Vice President of Corporate Finance of Santander México. He has 17 years of experience working with Santander, and his responsibilities include the execution and distribution of fixed income securities in Santander Sefarín. He has successfully sold important securitizations including the 2.5 billion peso State of Chihuahua toll road system. Mr. Friere has a B.S. in Economics from the Instituto Tecnológico Autónomo de México and a Masters in Business Administration from the Instituto Panamericano de Alta Dirección de Empresa.

Iñigo de la Borbolla has served as a Vice President in the Investment Banking area of Santander México since 2000. He works developing the public placement of fixed income securities in the local market, principally in the municipal bond market. Mr. de la Borbolla has a B.S. in Economics from the Universidad Panamericana and a Masters in Administration from the Instituto Panamericano de Alta Dirección de Empresa.