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Foreign Law in Transactions Between the United States and Latin America

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FOREIGN LAW IN TRANSACTIONS BETWEEN THE U.S. AND LATIN AMERICA

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SUMMARY

I. INTRODUCTION: ONE INTERNATIONAL PERSPECTIVE AMONG MANY

The topic of *Foreign Law in International Legal Practice* is often discussed primarily in the context of litigation, conflict of laws and the extraterritorial application of the laws of a country. Another perspective arises from international business transactions. In this context, the international transactional lawyer is to a large extent a corporate generalist who must take into account and address the additional legal issues inherent in a cross-border transaction.

My perspective on the application of foreign law in an international legal practice is the product of twelve years of transactional experience representing U.S. clients in Latin America and Latin American clients in the United States. Four of those years were spent opening and working in the Mexico City branch office of Gardere Wynne Sewell LLP, which has now been in operation since 1992. With Mexico's entry into the General Agreement on Tariffs and Trade (GATT) in 1986 and since the adoption of the North American Free Trade Agreement (NAFTA) in 1992, there has been more than a one hundred percent increase in cross-border investment

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between the United States and Mexico[1]. After President Ernesto Zedillo and Central Bank Governor Guillermo Ortiz adopted a tough macroeconomic policies, an improving infrastructure, growing skilled labor pool, and close proximity to the world's largest marketplace pushed Mexico, in 1999, to became the eighth largest exporter in the world.[2] Naturally, much of the expansion in Mexico's export capacity is a result of the sustained level of investment by U.S. companies in the past ten years. It is this type of economic activity that has been the "bread and butter" of the Mexican offices of U.S. law firms. Much of this investment activity has taken place through traditional merger and acquisition transactions such as purchases of Mexican companies by U.S. investors, or U.S. companies establishing either wholly-owned local operations or forming equity joint ventures. It is these types of transactions, particularly joint ventures with privately-owned Latin American businesses, that are in large part the context for my discussion of foreign law in international business law practice.

This article is not intended to be an exhaustive review of how foreign law may play a role in an international business transaction. Instead, this article focuses on a group of issues out of many others not discussed that can arise in an inbound investment from the United States to Latin America and discusses how these issues may need to be addressed in the underlying documentation reflecting the investment. A U.S. lawyer working on a cross-border investment can expect that some of these issues may arise and should work to spot these issues and provide his client with practical solutions. As the U.S. economy becomes further linked to other economies in this hemisphere, U.S. counsel will need to become better acquainted with doing business in Latin America and prepared to help their clients be successful in these markets.

II. FOREIGN COUNSEL: RELATIONS WITH YOUR LATIN COUNTERPART

Throughout Latin America, many businesses employ in-house lawyers to handle routine corporate matters (e.g., maintenance of corporate books and records, documenting powers of attorney, and contracts), deal with labor disputes arising from the termination of employees, and attend to routine litigation matters, particularly those dealing with the collection of unpaid accounts. While many in-house lawyers are well-trained in the civil law tradition of practicing law, few have substantial experience in cross-border matters with U.S. companies and investors who operate in common law jurisdictions. These Latin American businesses may retain outside legal counsel for those non-routine matters. These outside firms may range from small boutique firms to the largest local firms located in the country's commercial centers. On some occasions, even large businesses may rely on a small law firm for all of their needs in lieu of hiring in-house counsel. Such a firm may or may not have substantial experience in international projects. Since many larger Latin American law firms have sophisticated lawyers well-versed in cross-border transactions, negotiation of a business transaction with such lawyers, many of whom have studied or worked in Europe or the United States, may not be significantly different than working with U.S. counsel. However, if the local lawyer is not bilingual and has not had appreciable international experience, negotiating a business transaction may be more complicated.

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1 From 1995 to 1999, foreign investment in Mexico was U.S.$54.5 billion, compared to U.S.$27 billion dollars invested from 1990 to 1994. Foreign Investment in Mexico is expected to reach U.S.$12.377 billion in 2000. For more information, please refer to the website of the Mexican Ministry of Trade and Industrial Development (*Secretaría de Comercio y Fomento Industrial), Foreign Direct Investment in Mexico is expected to Reach US$12.377 Billion in 2000*, *at* http://www.naftaworks.org/papers/2000/fdi2000.htm (last visited July 26, 2001).

2 Joel Millman, *Trade Wins: The World's New Tiger on the Export Scene Isn't Asian; It's Mexico*, WALL ST J., May 9, 2000, at A1.

In any transaction, the process of negotiation involves developing a rapport with the foreign lawyer. If the lawyer is not fluent in English or experienced in dealing with lawyers from the United States, one may find that the foreign lawyer finds the approach of the U.S. lawyer to be overly aggressive. Sometimes the best approach is to first develop a rapport and basic level of trust with the local lawyer so as to clearly understand the expectations and capabilities of your foreign counterpart. On one equity joint venture project in Barranquilla, Colombia, our opposing counsel was in-house counsel in a recently privatized energy company. Since a majority of this company had been purchased by foreign investors, a new joint venture agreement was being negotiated in English. However, although most of our negotiations were conducted in Spanish, the in-house counsel refused to discuss or refer to the English version of the joint venture agreement (which he could read), even though that version would in fact be the version to be signed by the parties. Nevertheless, in order to accommodate the in-house counsel, we prepared a Spanish translation of the joint venture agreement for his convenience.

It is also important to understand the dynamics between your foreign counterpart and his client. Particularly when the client is the lawyer's sole or primary client, you may find that the lawyer may modify or even reverse himself on his interpretation of the application of local law based on the instructions and business demands set by his client, particularly if the application of local law is not clear. The client may also choose to keep his lawyer uninformed on matters that affect how the transaction is structured to comply with applicable laws. For example, on one transaction in Querétaro, Mexico, where a U.S. company was attempting to form a manufacturing joint venture with two Mexican partners, the lawyer representing the other party on several occasions, provided comments to the draft agreements that did not take into consideration the new business terms that had recently been negotiated by the principals. After this happened several times, we concluded that the lead Mexican party probably was allowing this to happen in order to force us to spend more time updating his own counsel and therefore less time focusing on how the documents could be made to provide greater protections for our client.

III. LANGUAGE: ARE YOU COMMUNICATING?

The ability to communicate effectively is fundamental to the success of transactional negotiations. Although today most large sophisticated businesses in Latin America have executives that are comfortable carrying out negotiations and drafting in English, U.S. companies that have project teams staffed with bilingual *and* bicultural members are likely to be more effective than their U.S. counterparts who expect the foreign partner or target to follow U.S. practices when structuring in-country investments in Latin America. Unlike projects where Latin American companies attempt to access the U.S. or European capital markets (and thus should be prepared to play entirely by the rules of these markets), an inbound investment into Latin America by a U.S. company, whether acting as an operating or passive partner, involves an entirely different set of negotiating dynamics.

I highlight bicultural as well as bilingual team members because just speaking the language is not always enough to facilitate a negotiation. U.S. counsel working on a transaction in Latin America must also be attuned to local customs and practices and, perhaps most importantly, counsel their client on what adjustments must be made to facilitate negotiations. For example, years ago in Mexico City, we had the opportunity to work on a large infrastructure public bid project. One of the U.S. executives of our client chose to show up at a meeting with our local partners toting a small oxygen tank and mask due to his annoyance with Mexico City's air quality. Notwithstanding the city's notoriously high altitude and smog, this insensitive gesture was not lost on the other side and engendered plenty of ill will during the negotiations.

When it comes to preparing documents for an inbound transaction into Latin America, most U.S. companies and their counsel generally prefer, and in fact expect, to work with U.S.-style documents in English that are governed by the laws of the United States or of a country other than the country in which the investment is being carried out. (Only when the investment involves a public bid process involving a local government are foreign investors readily willing to waive this requirement). The benefit to a U.S. company is clear. The familiarity of U.S. management and counsel with these documents makes it easier for necessary corporate approvals to be obtained. In addition, if the choice of law provision is valid and enforceable, the U.S. investor will have access to a familiar and presumably neutral forum to litigate any disputes arising from the underlying documents, and the local partner will be more inclined to settle disputes.

However, if the U.S. company agrees that the contract should be governed by the laws of a country with a civil law tradition, its U.S. counsel should expect shorter and simpler documents than those typically generated in the United States. Since the majority of legal rules and principles in Latin America are codified in codes or statutes, rather than established by judicial interpretation and the application of statutes and common law, the civil law practitioner relies on the applicable codes to establish many of the contractual rights of the parties. In addition, if any of those codified principles is a matter of public policy, then provisions in the contract whereby one party agrees to waive these provisions are unenforceable. Thus, contracts governed by the laws of a civil law country typically rely on the codified laws (without referring to them in the contract) to clarify the interpretation and effect of each contractual clause, rather than having the clause address all possible scenarios.[3]

Even if the project agreements are in fact U.S.-style documents, U.S. counsel will sometimes find that, at a minimum, the transaction documents will have to be negotiated in two languages. If the Latin American executives are not bilingual, they are not likely to execute an English-version document without at least reviewing an accurate Spanish or Portugese translation. The size of the principals will not necessarily obviate this cumbersome and costly task. In one natural gas project in Colombia, for example, our U.S. client required that the joint venture and shareholders' agreement be in English in order to obtain the necessary corporate approvals and funding commitments from the home office. However, because several of the local Colombian partners did not have bilingual executives, each draft of the agreement was simultaneously translated into Spanish. In another project in Mexico involving a bid to modernize a PEMEX petroleum refinery, comments to the Engineering and Procurement Contract that we were preparing on behalf of an international consortium were submitted in English, Spanish, and Korean (from three different working drafts) for incorporation into one operative English document.

3 *See* Javier Jiménez Gutiérrez, Legal Letter, *The Civil Law and the Mexican Legal System: A Word of Caution to Common Law Layers,* DOING BUSINESS IN MEXICO, Mar. 2000, at 6-7.

When negotiating a document that will be translated, it is important to include in the agreement a clause specifying which version controls in the event of a discrepancy in the translations. Alternatively, the parties can provide that a translation may only be adopted as a valid translation by mutual agreement of the parties. Regardless of the solution, in the event that the contract provides for disputes to be resolved in the courts of a foreign country, the U.S. party needs to understand that the matter will likely be reviewed by the local court using a translation prepared by a locally licensed translator.[4]

IV. CORPORATE AUTHORITY: HOW IS CORPORATE AUTHORITY ESTABLISHED AND EXERCISED?

In typical U.S. acquisition agreements, it is customary for each party to include a section of representations and warranties that includes a representation that all necessary corporate approvals have been obtained and that the person who executes the agreement on behalf of a particular party is duly authorized to execute such agreement. Such authority is normally derived from the bylaws of the company, which clearly define the authority of the various officers, as well as one or more corporate resolutions adopted by the board of directors granting more specific authority to the officer to negotiate and execute documents in connection with the transaction. Typically, the acquisition agreement will also provide that each party will make available to the other copies of the aforementioned agreements in order for each party to determine if the necessary corporate approvals have been obtained.

Conversely, in many civil law jurisdictions, the local civil code establishes specific categories of grants of authority that may be issued by a principal to an agent. This also includes grants of authority by a corporation to its officers. In Mexico, Article 2554 of the Federal Civil Code provides three categories of general grants of authority *(poderes generales)* that may be granted without limitations. Corporate officers may be granted authority to: (i) administrate corporate affairs (e.g., execute contracts); (ii) initiate and defend against litigation; and (iii) purchase or dispose of corporate assets.[5] In addition, under the General Law of Instruments and Credit Operations, the company may grant the officer the authority to execute credit instruments, undertake credit transactions, and issue checks from the corporate bank account.[6] Thus, while the bylaws *(estatutos)* of a Mexican corporation (*sociedad anónima*) specifically define the authority of the shareholders and the board of directors, the bylaws typically do not specifically create one or more officer positions with clearly defined authority. Instead, the bylaws simply provide that the shareholders or the board of directors may designate one or more individuals to exercise the authority granted to them by the shareholders or the board.[7] The authority granted to these individuals is memorialized in the transitory clauses of the incorporation deed (similar to the organizational minutes of a U.S. corporation) or in powers of attorney (*poderes notariales*) reflected in separate instruments issued by the shareholders or the board of directors.

4 *See, e.g.*, CÓDIGO FEDERAL DE PROCEDIMIENTOS CIVILES [C.F.P.C.] art. 132 (Mex.).
5 *See* CÓDIGO CIVIL PARA EL DISTRITO FEDERAL [C.C.F.] art. 2554 (Mex.).
6 *See* LEY GENERAL DE TÍTULOS Y OPERACIONES DE CRÉDITO (L.T.O.C.) art. 9 (Mex.).
7 *See* LEY DE SOCIEDADES MERCANTILES [L.S.M.] art 146 (Mex).

Thus, unlike the bylaws of a Texas corporation that specifically list and define the authority of those officers that are required by statute to be appointed for a corporation,[8] the bylaws of a Mexican corporation only provide that the board of directors may appoint such persons as the board chooses to act on behalf of the corporation. As a result, individual officers of Mexican corporations do not receive any grant of authority from the bylaws when they are later designated as corporate officers. Instead, each individual is granted her authority solely by means of the specific grant of one or more of the types of authority described in the preceding paragraph and documented in a public deed prepared (*protocolizado*) by a Mexican notary public. In interpreting the scope of the grant of authority by a Mexican corporation, the presumption is that an individual does not have authority to carry out certain actions unless a power of attorney is granted to him.[9] Thus, in a due diligence review of a Mexican corporation, the review of the powers of attorney issued by a corporation, not just the bylaws, is necessary to determine which individuals are authorized to act on behalf of the corporation.

Conversely, in Colombia, grants of corporate authority are interpreted broadly. If the shareholders or partners of a Colombian corporation (*sociedad anónima*) or limited liability company (*sociedad de responsabilidad limitada*) designate an individual as a representative (*apoderado*), it is presumed that the individual has unlimited authority to act on behalf of the entity, provided the representative acts within the corporate purpose of the company.[10] If the shareholders or partners want to impose limits on such authority, they must include such limitations in the bylaws and register the limitations with the Registry of Commerce.[11] Thus, depending on the jurisdiction of the transaction, even fundamental concepts such as corporate authority and how it is granted and recorded may need to be addressed very differently from standard U.S. practice.

Since confirming the authority of a corporate representative in Latin America almost always depends on reviewing documents issued by a notary, one can never forget the role of the notary public in a civil law country. As opposed to a Texas notary public, who is simply licensed by the Secretary of State to attest to the fact that a person has executed a document in the presence of the notary, the notary public in Latin America is a lawyer who must carry out additional studies in order to obtain a license (*patente*) to serve as a notary public.[12] In mexico, for example, the notary not only has public faith *(fe pública*), but also reviews documents for legal content in order to determine if they comply with Mexican law.[13] Notarized documents are deemed to be public documents (*documentos públicos)* and, therefore, the certifications from the notary regarding the document's compliance with applicable laws may not be contested.[14] With respect to corporate documents, the notary public must review and register the charter of a company in order to form the legal entity and record same with the Public Registry of Commerce and Real Property (*Registro Público de Comercio y la Propiedad*) for the corresponding state.[15]

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8 *See* TEX. BUS. CORP. ACT. ANN. art. 242(B) (Vernon 2001).
9 The concept of strict interpretation of grants of authority is derived from Article 2583 of the Federal Civil Code. *See* 2583.
10 *See* NUEVO CÓDIGO DE COMERCIO [N.C.C.] [.§1321] art. 196 (Colom.).
11 *See id.*
12 *See generally* RUDOLF B. SCHLESINGER ET AL., COMPARATIVE LAW: CASES, TEXT, MATERIALS 22-24 (6th ed. 1998)
13 *See* C.F.P.C. art 202.
14 *See id*.
15 *See id*.

V. CURRENCY AND PAYMENT ISSUES: GETTING MONEY BACK HOME

Typically, U.S. clients prefer that the international contracts that they enter into specify all monetary amounts in U.S. dollars. The stability of the U.S. currency and the concern that foreign currencies may be subject to unpredictable devaluations only serve to strengthen the client's resolve to stand firm on this issue. The reality of many overseas transactions, however, is that foreign operations and investments may not always generate income in U.S. dollars. In addition, local transactions may need to be reflected in local currency. Since companies in Latin America must maintain their accounting records in local currency and in accordance with local generally accepted accounting principles, it is often necessary to plan for the inevitable conversion of local currency into dollars, or vice versa, and it is therefore advisable to specify the mechanisms in the underlying agreement to account for such currency conversions. In addition, the agreement should address what happens if the payment is made in a local currency and the foreign party has problems remitting the funds abroad.[16]

Some countries like Brazil have statutory currency conversion restrictions that require that foreign currency be converted into local currency before entering the country.[17] For example, for a loan made by a U.S. company or bank to a Brazilian corporation, the loan proceeds provided to the Brazilian borrower must first be remitted to a Brazilian bank along with the execution of a foreign exchange contract. The local bank must then register the financing documents with the Central Bank of Brazil before the funds can be released to the Brazilian borrower.[18] In Brazil, a foreign investor making an equity investment must also enter into a foreign exchange contract with a Brazilian bank, register such investment within thirty days of wiring the funds to Brazil, and ultimately obtain the corresponding Certificate of Foreign Investment from the Central Bank in order to comply with the provisions of the typical foreign exchange contract.[19] A failure to register the investment will restrict the ability of the foreign investor to repatriate capital at its discretion. In addition, the conversion may have to be carried out through market procedures much less attractive to the foreign investor.

Alternatively, in countries with a floating currency like Mexico, a contract specifying a conversion from pesos to dollars will typically refer to the official currency conversion rate published by Banco de México, the Central Bank, as the basis for such conversion. Alternatively, since there is a difference (i.e., a trading band) between the rate to buy dollars with pesos versus the rate to sell dollars, you may also designate one of these rates as quoted by a local bank, or even adopt an average of the two, as the basis for the conversion. No matter which conversion measure is chosen, it is imperative that the date used to calculate such conversion be clearly specified.

Counsel should be cautious of little-known local rules regarding the payment of obligations in foreign currencies that may be traps for a U.S. client and its counsel. For example,

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16 For example, the agreement can require that the local party that owes the money establish an offshore account and direct its foreign customers to pay the money that they owe into this offshore account in US. dollars. Alternatively, the agreement can establish a separate debt obligation to be paid by the local party in the event that the foreign creditor receives fewer U.S. dollars than the agreement originally called for due to currency conversion issues.

17 *See* Lei No. 4.131, art. 5, de 3 de setembro de 1962, D.O.U.de 07.11.1962 (Braz.)

18 *See* CARTA CIRCULAR No. 2933, Banco Central do Brazil [Central Bank of Brazil], ¶¶ 2, 4, de 30 de agosto de 2000, *available at* http://www/bcb.gov.br/mPag.asp?codP=106&cod=112&perfil=1 (last visited May 9, 2001).

19 *See* Lei No. 4131, art. 5, de 3 de setembro de 1962, D.O.U. de 07.11.1962 (Braz.).

promissory notes between a U.S. payee and a foreign payor will typically establish that the payment obligation must be paid to the payee in dollars. However, establishing the place of payment is also important. In Mexico, unless the promissory note provides that the payment must be made outside of Mexico, the Mexican payor has the right to pay the obligation in Mexico in pesos, notwithstanding that the instrument provides for payment in U.S. dollars.[20] The preceding problem will not be overcome by a choice of law provision that designates the laws of a country other than Mexico. This is because the provision of the Mexican Monetary Law (*Ley Monetaria*) in question is deemed a public policy law (*ley de orden público*), which cannot be waived.[21] Thus, if a foreign court issues a judgment against the Mexican debtor requiring the debtor to pay the debt in dollars in Mexico based on the interpretation of the promissory note in accordance with the laws of a foreign country, a Mexican court will most likely not enforce the foreign judgment (using the civil procedure for executing local judgments known as *homologación* [22]) because the foreign judgment violates Mexican public policy. Unfortunately for the foreign creditor, the debtor's ability to tender the amount in question in pesos may create an unexpected currency conversion cost for the foreign creditor. In addition, allowing the payment to be made in Mexico may also create other problems. For example, it is also typical in cross-border financings that the local borrower will "gross-up" the payments of interest so that the foreign lender is indemnified from having to pay foreign income tax on the interest made off the loan. Thus, if the payment is made to the lender in Mexico and the "gross-up" provision is not contained in a separate document, the lender may lose its ability to have the borrower pay for the Mexican income taxes that must be paid when repatriating the interest payments to the U.S.

VI. LICENSING OF TECHNOLOGY: USE IT OR LOSE IT

Most U.S. companies with valuable intellectual property or know-how will try to register same before the U.S. Patent and Trademark Office in order to establish their ownership. In addition, they should also register such technology before local intellectual property registries in order to enhance their ability to protect such intellectual property in foreign countries. However, simply registering the trademark before the local patent and trademark office may not be sufficient if the U.S. company will not directly use the trademark in the foreign country, but instead plans to establish use through a subsidiary or third party.

Mexico provides a typical example. Due to the provisions of the Mexican Intellectual Property Law *(Ley de la Propiedad Intelectual*), it is also important to prepare a license agreement between the U.S. owner of the registered trademark and the Mexican licensee, including its own subsidiary, in order to show use of the licensed trademark and avoid claims by third parties that the trademark has been abandoned[23]. The Mexican Intellectual Property Law provides that a trademark will be deemed abandoned if the owner of the trademark, or the licensee that is using such mark pursuant to a license agreement duly-registered with the Mexican Institute of Intellectual Property (*Instituto Mexicano de la Propiedad Industrial* or "IMPI"), does not use the mark for three consecutive years[24]. Although failing to register the license agreement does not prejudice the rights of the licensor vis-à-vis the licensee, it does mean

20 *See* LEY MONETARIA DE LOS ESTADOS UNIDOS MEXICANOS [L.M.] art. 8 (Mex.).
21 *Id*. Art. 9.
22 *See* C.F.P.C. arts. 570 & 571.
23 *See* LEY DE LA PROPIEDAD INDUSTRIAL [L.P.I.] art. 152 (Mex.).
24 *See Id*. art. 130.

that the licensor will not have established a prima facie case of use of the trademark whereby all third parties are deemed to be on notice of the registration and use of the trademark in Mexico.[25]

Brazil also demonstrates how failing to complete such registration may cause additional problems for the foreign licensor. Pursuant to Law No. 9279 of the new Intellectual Property Law *(Lei de Propriedade Industrial*), a registration of the license agreement with the National Registry of Intellectual Property (*Instituto Nacional de Propriedade Intelectual*) is required in order for the license to be valid and enforceable, thus allowing the licensee[26] to deduct royalty payments paid abroad to the licensor. In addition, the licensee may not repatriate the royalty payments without Central Bank approval.[27]

The importance of these registrations becomes even more obvious when you consider that in many civil law countries, many equitable remedies (e.g., specific performance) may not be generally available through the judicial system. Therefore, having all of the necessary registrations in place with the local patent and trademark office may provide the only effective remedy for the foreign owner.

VII. CORPORATE GOVERNANCE: BEING A LOCAL OWNER

The creation of equity joint ventures in Latin America whereby the joint venturers agree to form a new legal entity must also address clearly how decisions by the shareholders, members, board of directors or board of managers will be taken. Since this area of corporate law in the United States is well developed, U.S. companies and counsel will try to adapt many of their battle-tested corporate governance techniques to overseas entities. However, great care must be taken to insure that corporate governance techniques available in the United States are not deemed unenforceable under local law, particularly since, in the event of a dispute between the joint venture partners, the bylaws of the new joint venture entity will probably supercede conflicting provisions of separately prepared joint venture and shareholders' agreements, particularly those drafted in English and subject to the laws of a country other than the one where the joint venture entity was formed.

In Mexico, one particularly troubling provision of law to many U.S. investors is the "Calvo clause" which must appear in the bylaws of any Mexican legal entity wherein foreigners will own equity.[28] The Calvo clause is drawn from Article 27 of the Mexican Constitution and is typically worded as a pledge by foreigners who become shareholders, members, or partners in Mexican legal entities to agree to be treated as Mexican for purposes of the determination of their rights and obligations in the entity with respect to the other owners and not to invoke the protection of their home government in connection with disputes with the other owners.[29] The clause also provides that the foreigner will forfeit its equity investment in the Mexican company to the Mexican nation if it violates the clause.[30] Although, on its face, it may appear to be an unreasonable request, a foreign investor may not own equity in a Mexican company without agreeing to these terms. This historical legacy from the days of the Mexican revolution can be

25 *See Id.* art. 136.
26 *See* Lei No. 9.279, art. 211, de 14 de maio de 1996, D.O.U. de 15.05.1996.
27 *See* Lei No. 4.131, art. 5, de 3 de setembro de 1962, D.O.U. de 07.11.1962 (Braz.).
28 *See* CONSTITUCIÓN POLÍTICA DE LOS ESTADOS UNIDOS MEXICANOS [CONST.] art. 27 .§ I (Mex.).
29 *Id. See also* LEY DE INVERSIÓN EXTRANJERA [L.I.E.] art. 7 (Mex.).
30 *See* CONST. art. 27. *See also* L.I.E. art. 7.

complied with while still providing adequate protections to the U.S. investor in other provisions of the bylaws.

The flexibility of determining corporate governance will also be determined in part by the type of entity chosen for a new equity joint venture. For example, in Mexico the *sociedad anónima* and in Brazil the *sociedade anônima* are the entities generally used for commercial operations. These entities provide the four typical characteristics of a U.S. corporation (limited liability, centralized management, free transferability of interests, and unlimited duration).[31] However, a limited liability company in Mexico (*sociedad de responsabilidad limitada* or "SRL") and Brazil (*sociedade de responsabilidade limitada* or "*Limitada*") provide much greater flexibility for establishing corporate governance rules than do regular corporations. In addition, with the exception of the requirement that a minimum of the majority of members must approve transfers of the membership units by existing members to third parties, the *estatutos* or *contrato social* do not have to include any of the provisions required by the general corporate law in connection with protecting the rights of minority shareholders. Finally, in Brazil, use of the *Limitada* also avoids the requirement applicable to Brazilian corporations to publish their formation documents and some financial information in the Official Gazette *(Diário Oficial*).[32] These entities may therefore be more attractive to U.S. investors that wish to reduce minority shareholder rights that are legally mandated in a local corporation.

When the terms and structure of the transaction require the use of a foreign corporation, the U.S. principals should have experienced local counsel to take advantage of any unique features that may favorably distinguish one foreign entity from another. For example, in one manufacturing equity joint venture in Monterrey, Mexico, our U.S. client was the 51% owner of the new entity formed to operate the local manufacturing plant. The Mexican minority partner insisted on supermajority approval (i.e., requiring the approval of one of the directors appointed by the Mexican partner) of actions required to be taken by the board of directors to approve certain matters not reserved to a shareholders' meeting. Under the Mexican General Law of Commercial Entities (*Ley General de Sociedades Mercantiles*), there is a listing of corporate actions that must be approved by the shareholders in an extraordinary shareholders' meeting (e.g., merger, dissolution, etc.), as opposed to an ordinary shareholders' meeting.[33] The basic difference between these two types of meeting relates to the quorum and voting requirements for adopting resolutions by the shareholders.[34] Thus, unless matters are reserved by statute or the provisions of the charter/bylaws for approval by the shareholders (whether at an ordinary or extraordinary meeting), these matters may be taken up by the board of directors.

In our client's Monterrey joint venture project, we prepared the bylaws so that if the parties became deadlocked at the level of the board of directors, they could resolve the matter at an ordinary shareholders' meeting where a majority of the shareholders present was sufficient to approve those actions under consideration (i.e., our client's 51% would be sufficient to adopt these actions whether the Mexican partner was present or not). Unfortunately for our client,

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31 In Latin America, however, most countries substitute unlimited duration for a term of ninety-nine years, which can later be extended.

32 The requirement to publish the formation documents only is applicable to traditional corporations (*sociedades anômimas*). Lei No. 6.404 art. 94, de 15 de dezembro de 1976, D.O.U. de 17.112.1977

33 *See* LEY DE SOCIEDADES MERCANTILES [L.S.M.] art. 182 (Mex.).

34 A quorum for an ordinary shareholders' meeting is fifty percent of the capital stock present, and resolutions must be approved by a majority of the shares present at the meeting. A quorum for an extraordinary shareholders' meetings is seventy-five percent of the capital stock present, and resolutions shall be binding if approved by shareholders representing fifty percent of the capital stock. The preceding quorum and voting requirements for both types of meetings can be increased, but not reduced, in the bylaws. L.S.M. arts. 189 & 190 (Mex.)

Monterrey counsel for the minority partner insisted that those matters requiring supermajority approval from the board of directors could only be reconsidered at an extraordinary shareholders' meeting, where our client did not own sufficient capital stock to unilaterally approve actions brought before the meeting. Nevertheless, in these transactions, you should actively seek to protect your client by the unique means available under local law.

In addition to obstacles arising from the mechanical application of corporate governance rules, local statutes may also establish basic requirements regarding the immigration status of the individuals in question that may disrupt a U.S. company's original plans on how to manage an overseas business. For example, presently in Argentina,[35] and until recently in Brazil,[36] a two-thirds majority of the members of the board of directors of a corporation had to be residents.

VIII. RESTRICTIONS ON THE SALE, TRANSFER OR VOTING OF STOCK: NOW THAT YOU OWN IT, WHAT CAN YOU DO WITH IT?

In Latin America, the freedom of parties to contractually agree to prohibitions or limitations on their rights to sell or vote shares or equity interests in a local entity is often limited by local statutes. However, these same statutes usually contain special provisions that may allow some flexibility on restricting transfers in the local joint venture entity. An obvious contrast in a shareholders' ability to contract is notable when comparing the corporate statutes in Texas and Mexico.

The Texas Business Corporation Act provides that a restriction on the transfer of shares may be imposed by the articles of incorporation, the bylaws or a written agreement between the shareholders, provided that the agreement is placed on file with the corporation for examination by all of the shareholders.[37] Conversely, for Mexican corporations, the general rule established in the civil code is that conditions may be applied to a sale of shares, provided that the conditions do not represent an absolute prohibition on the sale of the shares.[38] The Mexican corporate statute does provide that the bylaws may require the prior approval of the board of directors for a transfer of stock, provided that the board of directors may only reject the proposed sale if it finds another buyer willing to buy the shares at the fair market price.[39]

As discussed in Section VII above, in many Latin American countries, the use of another type of legal entity may facilitate the creation of restrictions on the sale of equity interests to a third party. By using a Mexican SRL or Brazilian Limitada, the foreign investor may require that any transfer of the membership units requires the approval of the remaining members, thus providing it with a veto right on all transfers. If the foreign investor needs to use a corporation, at least in Mexico, another alternative is to establish in the bylaws that (i) a sale of the shares must be approved at a shareholders' meeting by a majority of the shareholders or that the shareholders, at their meeting, must find an alternative buyer, (ii) any interested shareholder should not vote its shares at such meeting, and (iii) an interested shareholder that in fact votes for such sale will be liable to the corporation for any damages caused by such sale.[40] Finally, bylaws

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35 *See* Law No. 19950, Apr. 3, 1972, [1972-A] A.L.J.A. 478, *amended* by Law No. 22903, Sept. 9, 1983, [1983-B] A.L.J.A. 1632(Arg.).
36 *See* Lei No.6.404, de 15 de dezembro de 1976 (Braz.).
37 *See* TEX. BUS. CORP. ACT. ANN. art. 2.22(B) (Vernon 2001).
38 *See* C.C.D.F. art. 2301.
39 *See* L.S.M. art. 130.
40 *Id*. art. 196.

could also establish a liquidated damages amount which the interested shareholder would be liable for if it voted to approve the sale of its shares and its approval of such action was deemed contrary to the interests of the company.[41] Thus, there may be many different means available under the local corporate statute to control, or at least discourage, certain actions by one or more of the shareholders.

The contrast between Texas and Mexico in connection with voting agreements is also similar. Unlike the Texas corporation law, which allows the shareholders to enter into an agreement on how to vote their shares,[42] an agreement by a shareholder in Mexico to vote its shares in a certain manner is generally unenforceable.[43] In these situations, it is advisable for the U.S. shareholder to memorialize the agreement at a shareholders' meeting held at that time, but condition the fulfillment of the actions authorized at the meeting upon certain future events. For example, if the U.S. shareholder is concerned that its Mexican partner will not agree to provide additional capital contributions to the corporation in the future, a shareholders' meeting should approve such future capital contributions upon the formation of the entity and have the shareholders subscribe the shares represented by their future capital contributions, but make payment of those shares contingent on conditions to be met in the future.

IX. FOREIGN INVESTMENT RESTRICTIONS: CAN YOU GET IN THE GAME?

In carrying out a merger or acquisition transaction or creating a new joint venture entity with a local partner, U.S. counsel must consult with local counsel at the outset to determine if there are statutory restrictions that prohibit the U.S. investor from carrying out the transaction as originally contemplated. If foreign investment restrictions are in fact in place, U.S. counsel should then determine with local counsel if any treaties exist between the United States and the foreign country that might exempt the investment from the local statutory restrictions.

With the entry into the NAFTA on January 1, 1994,[44] the Mexican foreign investment law was revised to replace the Law to Promote Mexican Investment and Regulate Foreign Investment (*Ley para Promover la Inversión Méxicana y Regular la Inversión Extranjera*)[45] with the current Mexican Law of Foreign Investment (*Ley de Inversión Extranjera*). The current Mexican Foreign Investment Law provides six categories in connection with potential foreign investment: (i) activities reserved to the Mexican government; (ii) activities reserved to Mexican nationals or companies that prohibit foreign ownership in their bylaws; (iii) activities in which foreign investment is automatically approved for shareholdings ranging from 10% to 49%; (iv) activities in which a foreign investor may, with the prior approval of the National Foreign Investment Commission (*Comisión Nacional de Inversión Extranjera* or "FIC") own more than 49% of the equity in a Mexican company; (v) areas in which there is a limitation on foreign investment but in which the statute provides for a gradual phaseout of such restrictions;[46] and (vi)

41 *See* L.S.M. art. 196.
42 *See* TEX. BUS. CORP. ACT. ANN. art. 2.30(B).
43 *See* L.S.M. art. 198.
44 *See* 19 U.S.C. § 3311 (1999).
45 *See* LEY PARA PROMOVER LA INVERSIÓN MÉXICANA Y REGULAR LA INVERSIÓN EXTRANJERA [LAW FOR THE PROMOTION OF MEXICAN INVESTMENT AND FOR THE REGULATIONS OF FOREIGN INVESTMENT] (Mex.).
46 For example, currently foreign investors may only own up to 49% percent of certain parts of the transportation sector. However, the transitory clauses of the Foreign Investment Law establish a phase-out schedule whereby this limitation increased on January 1, 2001 to 51% percent and be completely eliminated on January 1, 2004 to permit foreign shareholders to own up to 100%. *See* L.I.E. art 7.

activities which are not addressed in the Foreign Investment Law, which means that they are unrestricted.

However, if you are representing a U.S. or Canadian investor in a Mexican investment, you should not necessarily stop researching the matter even if there appears to be a limitation in the Foreign Investment Law. Article 1102 of the NAFTA provides that the investors of each of the three countries will receive the same regulatory treatment as residents of that country, subject to the carve-outs negotiated by each country and reflected in the annexes to the NAFTA.[47]

One example of an ambiguity in the Foreign Investment Law that may be overcome by a clearer mandate in NAFTA is the limitation on foreign companies providing tourist transportation services over land in Mexico.[48] In this area, the current statutory definition makes it likely that the regulators may apply the restriction more broadly than it was originally intended, particularly given the failure of the United States to comply with its commitment to open up the U.S. market to Mexican trucking companies in January 1995. In these situations, it is imperative to review the NAFTA and its annexes to determine if the reservations negotiated by Mexico provide a strong argument that the investment by U.S. or Canadian investors should be authorized. In fact, Annex I for Mexico provides for a phase-out whereby investors of the United States or Canada could own up to 49% in a Mexican corporation to be established in Mexico to provide tourist transportation services. Since the Foreign Investment Law was drafted to regulate foreign investment from all countries, it is often the case that the provisions of the NAFTA provide U.S. and Canadian investors with more favorable investment rules than those set forth in the Foreign Investment Law for the rest of the world.

U.S. counsel also need to be aware that the size of the transaction being pursued by its client may trigger additional regulatory hurdles. The Foreign Investment Law requires foreign investors to obtain the prior approval of the Mexican Commission of Economic Competition (*Comisión de Competencia Económica* or "CCE") in the event that the investment in question exceeds an amount in Mexican pesos published from time to time by the CCE.[49] Given that the same threshold is also provided for in U.S. dollars in the NAFTA,[50] in the event of a substantial devaluation of the Mexican peso, the notification threshold under the NAFTA may be much larger than the corresponding amount set forth in the Foreign Investment Law. For example, in a paint manufacturing joint venture concluded in the summer of 1995, we represented a Dutch company in a fifty-fifty equity joint venture with a Mexican partner. When we started our discussions with the client in the middle of December 1994, it was clear that the investment in question had to be reported to the CCE because the notification threshold under NAFTA was US $25 million[51] and the notification threshold under the Foreign Investment Law was approximately P$80 million, reflecting the applicable currency conversion rate at the time.

In late December of 1994, with the Salinas administration coming to a chaotic end, the Mexican government allowed the peso to devaluate. The Mexican currency losing almost half its value by the beginning of the second quarter of 1995. During this time, the parties to the

47 Article 1102 guarantees "national treatment" (*principio de trato nacional*). North American Free Trade Agreement, Dec. 17, 1992, art. 1102, 32 I.L.M. 605, 639 (1993) [hereinafter NAFTA].
48 *See* L.I.E. art. 6.
49 *See* L.I.E. art. 9.
50 *See* NAFTA, *supra* note 47, Annex I, 32 I.L.M. at 719.
51 *Id.*

transaction renegotiated the business terms since the underlying assets to be contributed in Mexico to the joint venture entity had lost almost half of their value in U.S. dollars. Similarly, we were able to avoid filing a notification to the CCE by carrying out the investment through a U.S. subsidiary of the Dutch company because, although the amount exceeded P$80 million, it did not exceed the notification threshold under the NAFTA, which had risen in Mexican pesos to approximately P$150 million. Although the CCE was not pleased by our interpretation that the NAFTA threshold overrode the lower notification threshold set forth in the Foreign Investment Law (simply due to currency fluctuations), it did finally agree with our argument given that U.S. and Canadian investors are guaranteed the preferential treatment provided under the treaty even if it conflicts with local statutes.[52]

If the foreign investor cannot own the percentage of shares that it wishes to own in the target company, it may also consider structuring the investment so that even though it cannot control the corporation by direct, majority ownership, it can use mechanisms such as supermajority voting provisions in the bylaws that provide veto rights and voting trusts or establish preferential shares, shares with limited voting rights or neutral "N" shares that allow it to receive the economic benefits from its investment without controlling the shares. For example, in one telecommunications joint venture in Mexico, the U.S. client was prohibited from owning more than 49% of the shares of the Mexican joint venture. However, for U.S. consolidation purposes, 2% of the shares were placed in a Mexican voting trust (*fideicomiso*) so that the U.S. company could obtain the accounting and tax benefits of consolidation, whereas the Mexican partner would vote the shares in the trust in order to comply with the Foreign Investment Law and maintain voting control.

U.S. counsel should also be aware that similar restrictions may arise for U.S. investors from industry specific regulations beyond those relating to foreign investment since many Latin American countries are still in the process of deregulating many of their industries. As an example, most countries in Latin America that have opened up their natural gas markets restrict the ability of an entity that holds a controlling interest in one area such as transportation to directly or indirectly hold a controlling interest in a company providing distribution services.[53] However, in a gas marketing project in Colombia, a client was able to avoid being barred from participating in two restricted areas by creating an ownership structure with local Colombian investors and Cayman limited partnerships that allowed it to meet the integration rules and also establish operational control as set forth in the Colombian Commerce Code.[54]

X. LABOR: HELP WANTED!

Labor law is one example where the differences between U.S. law and the law of many Latin American countries are significant. For example, labor relations between employees and employers in the United States are typically a matter of state law, with federal law providing additional protections, such as those against wrongful termination. Conversely, in most Latin American countries, labor law is regulated by one federal statute. In fact, in Mexico, certain

52 *See* NAFTA, *supra* note 47, art. 1102, 32 I.L.M. at 639.
53 *See* Reglamento de Gas Natural, art. 100 (Mex.).
54 *See* Nuev Código de Comercio [N.C.C.][§ 721] art. 261 (Col.).

labor rights of employees are guaranteed in the country's federal constitution.[55] These constitutional and statutory provisions generally provide a labor system that is designed to be more favorable to the employee. In practice, however, many times the individual protections afforded to employees by the law have been modified in practice to reflect the more competitive workplace.

A U.S. company that is seeking to purchase an existing company or create a new joint venture company in Latin America should have its human resources and legal department undertake a thorough review of the foreign country's labor laws to determine how those laws are applied in practice prior to undertaking an investment. This is particularly true if the U.S. investor is from a state that provides for "at will" employment, whereby subject to certain statutory limitations the employee and the employer may terminate their employment relationship at any time, without liability to the other. Conversely, in Mexico, minimum labor benefits (e.g., annual year-end bonus, overtime, vacation premium, seniority bonus) are established by the Federal Labor Law (*Ley Federal de Trabajo* or "FLL").[56] The same statute also provides for legally mandated severance to be paid to the employee upon termination, depending on whether there was "just cause" for such termination.[57] The FLL provides for a labor severance (*finiquito)* to be paid to all employees upon the termination of employment with an employer.[58] The *finiquito* typically includes those benefits that have accrued in favor of the employee in accordance with the FLL (e.g., the number of years worked is multiplied by the legally mandated seniority bonus, vacation bonus, etc.).[59] In addition to payment of the *finiquito*, if the employee is terminated other than for "just cause,"[60] the employee is also entitled to ninety days of the employee's integrated salary[61] and twenty days of his integrated salary for every year worked.[62]

When assisting the client in connection with a proposed acquisition of an existing company, counsel for the U.S. company also needs to determine if the local statutes require legally-mandated payments of profit sharing from the joint venture's operating profits to its employees. In Mexico, for example, employees are entitled to ten percent of the company's net earnings, before taxes.[63] In response to this provision, many companies with a substantial number of employees either (i) try to negotiate more favorable terms for the company to share profits with the labor union through a collective bargaining agreement; or (ii) form a separate labor subsidiary that leases the employees to the operating company at its cost, plus a small profit margin meeting the guidelines set forth by the Ministry of Finance.[64] This is typical throughout Latin America. In Brazil, companies must also allow employees to participate in corporate profits if the employees attain certain performance goals tied to productivity.[65]

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55 This is the case of payments of profit sharing by employers to employees guaranteed by the Mexican Constitution. Const. *See* CONSTITUCIÓN POLÍTICA DE LOS ESTADOS UNIDOS MEXICANOS [CONST.] art. 123 (Mex.).

56 *See* LEY FEDERAL DEL TRABAJO [L.F.T.] art. 5 (Mex.).

57 *See* L.F.T. art. 47.

58 *See* L.F.T. arts. 48,50.

59 *See id*.

60 Article 47 of the F.L.L. provides a broad list of actions or conditions that qualify as just cause (*causa justificada*) for termination. *See* L.F.T. art. 47.

61 Integrated salary includes wages and other compensation that may be added to wages (e.g., gratuities, bonuses, meals, private insurance, and education compensations) to calculate the integrated salary of the employee. *See* L.F.T. art. 84.

62 *See id*. art. 50.

63 *See id.* art. 117-20.

64 *See id*. art. 121.

65 Constituição Federal [C.F.] art. 7, XI (Br.)

In light of the preceding potential liabilities, if the U.S. company is planning an investment in an existing Mexican company, it should calculate those benefits that have accrued over the years for the employees of the Mexican target and remember that Mexican companies typically do not create reserves in a special account while these benefits are accruing, nor vest funds in a separate account to cover the severance obligations that may arise upon the termination of the employee.[66] If the joint venture entity assumes the employees from the local partner without their being terminated and paid the severance to which they are entitled under the Federal Labor Law, liability for their benefits will date back to the date they were hired by the Mexican partner under the concept of employer substitution (*substitución patronal*).[67]

If the prospective U.S. partner asks the Mexican partner to terminate all of its employees prior to assigning same to the joint venture, the Mexican joint venture partner will correctly argue that formally terminating the employees and having the joint venture entity rehire them would trigger an enormous and unnecessary cost to the Mexican partner. After all, under normal circumstances and over the course of time, many of the employees of the Mexican partner would either voluntarily resign, be terminated for "just cause", or agree to receive a severance package smaller than what is required by law based on the company's potential intent to defend against any claim that the employee was terminated without cause. One possible solution to this problem arose in a textile joint venture in Querétaro, Mexico where the parties agreed in the shareholders' agreement that in the event of a termination of the employees assumed by the joint venture entity, the Mexican partner would be solely liable for that amount of the severance payment that accrued prior to the date of their hire by the joint venture company. In addition, the joint venture and partners' agreement established an obligation for the Mexican partner to indemnify the U.S. partner (i) in the event that it had to contribute additional capital to the joint venture in order for the joint venture company to have the capital necessary to pay such severance, and (ii) from any liability arising from claims by the employees of the joint venture company against the U.S. partner or any of the assets that the U.S. partner leased to the joint venture for its planned manufacturing activities.

In connection with foreign investments and the creation of new operating subsidiaries abroad, U.S. counsel is often asked to prepare employment agreements for foreign executives similar to those documents typically used in the United States. However, in many Latin American countries, noncompetition provisions are deemed unenforceable. In Chile, a covenant to restrict an employee's abilities to pursue his trade is generally not enforceable although including such a provision in the employment agreement may have a chilling effect on the employee.[68] In Mexico, such covenants are also generally unenforceable, and therefore specific performance cannot be obtained against the individual.[69] However, one solution to consider is to have the employee agree that his failure to abide by the covenant will damage the company and establish a liquidated damages provision in the agreement. If the amount is reasonable in light of the compensation paid to the employee, it may in fact be enforceable.

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66 Instituto Mexicano de Contadores Públicos, A.C., *Principios de Contabilidad Generalmente Aceptados* [Generally Accepted Accounting Principles], Boletín D3 (1998).
67 *See* L.F.T. art. 41.
68 FIJA NORMAS PARA LA DEFENSA DE LA LIBRE COMPETENCIA [Translation] D.O., de 22 de diciembre 1973 (Chile).
69 The Mexican Constitution guarantees that no individual shall be impeded from carrying out his profession, industry, commerce or employment of his choice, provided that such activity is not illegal. CONSTITUCIÓN POLÍTICA DE LOS ESTADOS UNIDOS MEXICANOS [CONST.] art. 5 (Mex.).

XI. ALTERNATIVE DISPUTE RESOLUTION: RESOLVING YOUR DIFFERENCES

Probably nothing is more troubling to a U.S. company or counsel than to contemplate litigation in a foreign country, particularly one with a different language, customs and legal system. Particularly when creating equity joint ventures in Latin America, where (in the case of shareholder or member disputes) the underlying bylaws will likely supercede other documents, it is advisable for the U.S. party to agree in advance that all disputes will be resolved first by non-binding mediation and thereafter by binding arbitration. International arbitration allows the parties to find a competent and neutral forum to resolve their disputes. In addition, since the parties can establish the necessary credentials for the arbitrators from the start, they are more likely to end up before arbitrators with knowledge of their particular industry. Finally, since the United States and most of the countries in Latin America are signatories to the United Nations Convention on the Enforcement of Arbitral Awards,[70] enforcement of an international arbitral award is more likely to be successful than a foreign judgment because the local court cannot review the merits of the foreign judgment unless it violates the public policy of the local country.[71] Conversely, with judgments from foreign courts, the United States and many Latin American countries are not signatories to any convention or treaty regarding the enforcement of foreign judgments.

Finally, it is important to be sensitive to local concerns about choosing internationally recognized arbitration associations. Your Latin American counterpart may resist agreeing to arbitration before an agency that you have selected, particularly if it is the American Arbitration Association. As an alternative, allow each party to designate a preferred but recognized arbitration association, even if local,[72] and have the contract provide that whichever party requests arbitration must allow the arbitration to be conducted under the arbitration rules chosen by the other party.

XII. CONCLUSION

Every day it seems that the world grows smaller and that the pace of business, including business transactions, accelerates. As lawyers, whether in the United States or elsewhere, it is becoming increasingly difficult to keep abreast of legal developments and the necessities of your clients, particularly with the advent of e-mail, the Internet and electronic commerce. Nevertheless, these technological advances, as well as the growing interdependence of countries that have solidified trade relationships, also signal greater efforts to standardize the rules of international commerce. In Latin American, where there has been tremendous activity in privatizing and deregulating parts of the public sector, these changes are likely to be even more dramatic.

The creation of the Andean Pact, the NAFTA and MERCOSUR, among others, signal a determination by the governments of this hemisphere to institutionalize the existing ties and competitive advantages that already exist and to leverage off of those relationships in order to be more competitive with the rest of the world. As U.S. companies continue to expand southward

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70 *See* Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517.

71 *Id*. § 304.

72 For example, in Mexico, there are several new arbitration agencies, including the Centro de Arbitraje de México and the Cámara de Comercio de la Ciudad de México.

and take advantage of these opportunities, as well as dominant Latin American companies begin expanding northward, U.S. lawyers will need to be ready to help their clients assist with business transactions throughout the entire hemisphere.