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HIGHLIGHTS

Private Equity Regulation in Brazil, Colombia and Mexico Part II

The second installment of a two-part series from the New York City Bar Association Committee on Inter-American Affairs includes coverage of exit strategies and regulatory issues related to formation and operation of PE funds, foreign investment restrictions and tax issues. *Page 8*

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Surge in Private Equity and Venture Capital Investment in Latin America

By Alyson Sheehan

[EDITOR'S NOTE: *Venture Equity Latin America*, a sister publication to *Latin American Law and Business Report*, has just published its Mid-Year Report for 2010 and notes that transactions for PE/VC investors have surged 378% since mid-year 2009. For more information on VELA's Mid-Year Report, visit http://www.wtexecutive.com or contact Jay Stanley at 978-287-0391.]

The protracted, tenuous state of economic recovery in mature markets like the U.S. and Europe has blown the winds of change in Latin America's direction. From the number of deals made, to funds raised, to exits executed, capital levels across the region have skyrocketed over the last twelve months. This time last year, deals activity appeared to be on a downswing. Between 2008 and 2009, investment levels in the region tanked 24%, from $1.7 billion in private equity investments in mid-year 2008 to $1.3 billion in mid-year 2009. Some Latin countries, like Mexico, felt the repercussions of the global credit crunch and contraction in demand more acutely than others. Signs of optimism could be seen in the form of fundraising, where humbled investors shifted their attentions towards underserved emerging markets, and Latin America in particular edged its way under their spotlights.

In 2010, as foreign investors looked vigilantly towards the region, the Latin countries rolled out the welcome mats. Over the last year, significant regulatory moves have been made locally in Latin America, where governments in such countries as Colombia, Peru, Chile and Argentina have taken steps to convey a sense of stability and assuage concerns about unreliable legal environments. The privatization of pension funds has led some governments, such as Mexico's, to lift restrictions curbing their participation in the markets, which has significantly galvanized local capital being raised. The growth of the middle class in Brazil, Mexico and Colombia has engendered a belief in homeownership and having a stake in one's own society, which in turn has spurred growth in industries such as consumer products, housing and real estate, and food production and distribution.[1] The amalgamation of these political, social and economic factors contributing to Latin America's overall attractiveness brought about the region's exponential growth in the first half of 2010, when private equity and venture capital investment levels reached $6.21 billion, surging 378% since mid-year 2009.

Alyson Sheehan is an editor with WorldTrade Executive/ Thomson Reuters.

According to Erwin Roex of UK-based Coller Capital, limited partners are expecting to see their commitments growing even further in Latin America in the coming years. "If you look at where the vast amount of money went in recent years, before the crisis, it was to large buyouts, and these large buyouts are gone for the near future," Roex told VELA. "Now investors need to look for new opportunities to commit this money and emerging markets and Latin America feature prominently in their considerations."[2]

The protracted, tenuous state of economic recovery in mature markets like the U.S. and Europe has blown the winds of change in Latin America's direction.

Deals activity grew not only in terms of amount of capital invested, but also in number of transactions. The first half of 2010 saw the completion of 63 transactions, up from 29 transactions recorded in the 2009 VELA Mid-Year Report, demonstrating a positive correlation between transaction number and total capital invested this half-year. Moreover, demand among investors for larger assets increased considerably over the past twelve months. Nineteen private equity investments of over $50 million have been made so far this year, and the number of investments registered at $100 million or more was 12, compared to 3 in mid-year 2009 and 4 in mid-year 2008. Those 12 investments are:

- Advent International and other institutional investors' $100 million investment in International Meal Company, one of Brazil's largest restaurant management firms;
- Global private equity firm Apax Partners' $502 million investment in Brazilian IT and outsourcing firm, Tivit, for a 54.25% stake in May;
- UK-based private equity firm Ashmore Investment Management's $187 million investment, among a consortium of investors, in Colombian power firm Termoemcali in May;
- U.S.-based private equity firm Conduit Capital's $120 million investment in Jamaica Energy Partners in March;

Surge in Private Equity, Continued on page 4

Surge in Private Equity (from page 3)

- DLJ South American Partners' $370 million investment, among a consortium of investors, in Latin American educational book publisher Grupo Santillana de Ediciones for a 25% stake in May;
- U.S.-based hedge fund Eton Park Capital Management's $200 million investment in hydroelectric energy firm Hydrochile in February;
- Investment firm First Reserve Corporation's $500 million investment in Brazilian exploration and production startup Barra Energia Petroleo e Gas in May;
- Texas Pacific Group's and Gavea Investimentos' joint investment in Rumo Logistica for $226 million in June;
- MC Inversiones's $924 million investment in Chilean steel manufacturer Compania Minera del Pacifico, a subsidiary of CAP, for a 25% stake in February;
- Brazilian real estate company Odebrecht's $1.5 billion investment in the Southern Andean Pipeline project in March;
- U.S.-based private equity firm The Carlyle Group's estimated $250 million investment in Brazilian tour operator CVC Brasil for a 64% stake in January; and
- The Carlyle Group's $550 million investment in Bank of N. T. Butterfield & Son in March.

Much like last year, the financial services sector was a demonstrably popular one for investment, as 7 major deals pertained to that industry across Mexico, Colombia, Brazil and Ecuador.

The financial services sector was a demonstrably popular one for investment, as 7 major deals pertained to that industry across Mexico, Colombia, Brazil and Ecuador.

Energy was also a recurrently popular focus for investors, as it was the sector that not only accounted for 6 separate deals that took place but also almost a quarter of all funds raised this half year. U.S.-based private equity firm Conduit Capital, U.S.-based hedge fund Eton Park Capital Management, and social venture capital firm IGNIA Partners were among the top firms with the most pronounced presence in Latin America this half year.

IGNIA Partners, in particular, made three investments in Mexico in the housing, telecommunications and food production and distribution sectors as well as a fourth investment in Brazil pertaining to low-income healthcare services, education, housing and other basic services.

IGNIA's presence in Mexico helps illustrate the improvements that have taken place there over the last

Deal Amounts Per Country, 1H2005-1H2010

	1H2005		1H2006		1H2007		1H2008		1H2009		1H2010	
	# Deals	$ millions	# Deals	$ millions	# Deals	$ millions	# Deals	$ millions	# Deals	$ millions	# Deals	$ millions
Argentina	2	140.5	6	156.1	1	85.7	3	0	2	73.7	6	10
Barbados							-	-	-	-	1	550
Bolivia	-	-	-	-	2	NA	-	-	-	-	-	-
Brazil	10	325.09	11	218	16	631.64	10	588	10	1029.8	33	2102
Chile	4	21	6	511.8	2	150	3	914	2	NA	3	1161
Colombia	-	-	2	26	2	180	1	25	2	NA	3	212
Costa Rica	-	-	-	-	-	-	1	0	3	30.75	1	NA
Dominican Republic	-	-	-	-	1	NA	-	-	2	12	-	-
Ecuador	-	-	-	-	-	-	-	-	-	-	1	NA
El Salvador	-	-	1	NA	2	181.5	-	-	-	-	-	-
Guatemala	-	-	-	-	-	-	-	-	-	-	-	-
Guyana							1	0	-	-	-	-
Honduras	-	-	-	-	-	-	-	-	-	-	-	-
Jamaica	-	-	1	25	-	-	-	-	-	-	1	120
Mexico	4	50	9	269.61	7	240	7	129.5	5	36	8	165
Panama	-	-	-	-	1	5	-	-	-	-	-	-
Peru	3	14.5	-	-	4	45.2	-	-	1	1	3	1500
Paraguay	-	-	-	-	-	-	-	-	1	20	-	-
Puerto Rico	-	-	1	9	-	-	-	-	-	-	-	-
Regional	-	-	2	151	6	775	-	-	1	400	3	390
Trinidad & Tobago	-	-	1	2	-	-	-	-	-	-	-	-
Uruguay	-	-	2	169.75	2	0.8	-	-	-	-	-	-
Venezuela	-	-	-	-	-	-	-	-	-	-	-	-
Total	**23**	**551.09**	**42**	**1538.26**	**46**	**2294.84**	**26**	**1656.5**	**29**	**$1,307.50**	**63**	**$6,210**
(Financial Info. Available)	16		31		27		13		18		39	

Recent Private Equity Activity in Latin America			
	Deals	Funds	Exits
1H03	$213	$258	$213
2003	$822.00	$416.85	$1,098.20
1H04	$358.50	$108.24	$404.53
2004	$609	$714.00	$662.23
1H05	$551.09	$341	$720.00
2005	$1,015	$1,272	$1,494
1H06	$1,538	$291.20	$1,966
2006	$4,264	$3,209	$3,109
1H07	$2,295 (47 transactions)	$1,497 (20 closings)	$1,573 (22 transactions)
2007	$7,545 (84 transactions)	$4, 654 (29 closings held)	$5, 407 (43 transactions)
1H08	$1, 656.5 (26 transactions)	$1, 981.2 (17 closings)	$958.1 (5 transactions)
2008	$3,086.1 (34 transactions)	$5, 780.9 (25 closings held)	$1, 267 (10 transactions)
1H2009	$1307.05 (29 transactions)	$2,176.5 (18 closings held)	$2,600 (7 transactions)
2009	$2839.6 (67 transactions	$5034 (40 closings held)	$3543.01 (16 transactions)
1H2010	$6210 (63 transactions)	$4747 (27 closings held)	$5238 (16 transactions)
		in Millions U.S. $	

year, as there has been a continued momentum of venture capital investing in light of the country's risk profile and investment-grade status.[2]

Other testaments to Latin America's promising economic growth can be found in the turnout of fundraising activity and exit liquidity. In the first half of 2010, 27 fund closings amounted to roughly $4.7 billion in committed capital, illustrating a 114% growth increase year-over-year. Moreover, 16 exit disbursements totaled over $5.2 billion this half-year, illustrating a 100% growth increase year-over-year.

Clearly, then, the slow economic growth in the U.S. and Europe has had a positive impact on private equity in Latin America. Even in spite of concerns over Mexico's drug trafficking, or the earthquake that ravaged industries in Chile in February, or Colombia's reputation of being a "drug haven," competition is nonetheless growing among local and foreign investors across the region.

While legal instability remains a problem in Latin America by varying degrees from country to country, these economies overall are demonstrating a commitment to building positive environments for the private equity industry, and thanks to how relatively well it has weathered the financial crisis, opportunities for investment abound.

One of the most important challenges to face now, according to Roex, will be finding seasoned, experienced managers from the region who will be able to lead local firms through regional expansion.[4] ❑

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1 Fitzgerald, Michael, "Liquidity for M&A in Latin American in 2010," Latin American Law & Business Report, February 2010, p. 3
2 "Why Latin America is Gaining in Importance for Investors: An Exclusive Interview with Erwin Roex of Coller Capital," Venture Equity Latin America, Vol. IX, no. 11.
3 Fitzgerald, Michael, "Liquidity for M&A in Latin American in 2010," Latin American Law & Business Report, February 2010, p. 3
4 "Why Latin America is Gaining in Importance for Investors: An Exclusive Interview with Erwin Roex of Coller Capital," Venture Equity Latin America, Vol. IX, no. 11.

The Latin American Structured Finance Market: A Safe Bet

By Michael L. Fitzgerald
(Milbank, Tweed, Hadley & McCloy LLP)

As a result of some serious financial debacles over the past three to four years, the otherwise respectable strategy of structured finance has taken a major hit to its reputation. So it is not at all surprising that U.S. investors are wary when they hear talk of structured finance opportunities in Latin America.

But despite the recent—and not totally unfounded—caution, the reality is that structured finance is a viable, stable option that is really working in the economies of Latin America. And it is yielding some great results for investors who know how to use it to their advantage.

Structured finance is particularly suited for emerging Latin American markets, usually in countries with big commodity markets. This includes Brazil, Chile and Peru, with their booming markets in agriculture, oil and gas, and mining and metals. To a lesser—but still significant—extent, Mexico can also be counted among this group.

There are several reasons for these commodity-producing countries to gravitate toward structured securities. First, their commodity products are all priced in dollars, as opposed to the local currency. This practice insulates against the threat of devaluation of the local currency, which makes dollar denominated structured securities significantly more attractive to the worldwide investment community than most other emerging market investments.

Second, these commodity companies have the advantage of scale. Most of them are extremely large organizations that specialize in selling offshore—including to China. These companies have greatly benefitted from commodities prices that have gone through the roof as a result of the emergence of China as a manufacturing titan.

Finally, Latin American commodities companies have a real need for the money they pull from structured deals. Most of them have large capital projects to invest in, and for that reason, they require access to significant amounts of financing.

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As an example of what we're currently seeing in Latin America, there is interest in pre-export finance receivables transactions in commodity agricultural products like soybeans. These commodities are sold internationally, typically into a dollar-denominated export market. In a sense, these transactions can be considered secured loans because of the effective pledge of the commodity involved and the currency based on the U.S. dollar.

Latin American commodities companies have a real need for the money they pull from structured deals. Most of them have large capital projects to invest in, and for that reason, they require access to significant amounts of financing.

We might see, for instance, a soybean producer in Brazil secure the cash flow he gets from a dollar-denominated sale to China then place those monies in a safe jurisdiction like the Cayman Islands or another tax haven. This constitutes a standard securitization structure, and it is interesting in the current market for two important reasons.

First, any fears about overvaluation of local currency, such as what we sometimes hear in regard to the Brazilian real, are neutralized by the fact that the transaction takes place in U.S. dollars. Thus, currency risk is not an issue. Second, with the turbulent worldwide debt market in the past year—headlined by the meltdown in Greece—it becomes clear that structured deals are a safe bet because there is minimal credit risk.

In fact, those of us who really know the Latin American markets consider international commodity sales among the safest investments that can be made. That may be a surprising statement to anyone who knows the structured finance market only from experience within the U.S mortgage-backed market. Here, it is considered a highly speculative venture. In Latin America, just the opposite is true.

The Latin American commodities are secured by the pledge of receivables, and typically the buyers of these commodities are the largest companies in the world—such as gigantic steel companies in China, Germany and the U.S. The sheer size of these big purchasers virtually guarantees the safety of the investment. Add to that a very low currency risk, and we have a current reality in which Latin American countries are being viewed as among the safest places to invest in the entire world.

Despite the obvious benefits, there are certainly some obstacles that the Latin American structured finance market faces in the future. The first is, as mentioned previously, the poor reputation that afflicts the structured finance approach. There is a sort of knee-jerk reaction among many investors that if it is a structured deal, it is inherently bad or risky. By far, the majority of structured deals worldwide have been in mortgage-backed securities, and investors have seen that bubble burst, with disastrous consequences and a lot of media attention.

It is interesting to note that the real estate market in Latin America has remained constant throughout the meltdown that occurred elsewhere. Part of the reason for this is government-run programs in Latin America—particularly in Mexico, but also in Brazil—that support the mortgage market by underwriting the majority of mortgages that are written. This provides a government-sponsored foundation that supports the real estate market in those countries. As a result, the mortgage-backed securities market is entirely different in Latin America than it is in the U.S.

Granted, real estate in Mexico took a hit in the wake of the U.S. real estate market failure. However, after several months, when investors began to realize that the Latin American real estate market was clearly different from the U.S. market, smart investors began returning to Latin America and have reaped the benefits of their forward thinking and quick action. Before long, Latin American stocks were back to pre-crisis levels.

Moving forward, one of the most interesting areas for potential growth in the Latin American structured finance market is in Brazil, which is preparing to host the world at two gigantic sporting events: the World Cup soccer championships in 2014 and the Olympic Games in 2016. To prepare for the spectators and participants who will throng to the country for each of these events, Brazil has a lot of work ahead in terms of infrastructure development. There is talk, for instance, of the country's first high-speed train that will link Rio de Janeiro and São Paulo.

The demand for infrastructure development already existed in Brazil's export-driven economy. However, the country's selection to host the World Cup and the Olympics in almost back-to-back years have exponentially increased that demand. Roads, railways, ports, electricity, water and a wide range of other improvements and expansion will have to be in place within four very short years. With this sort of time pressure, we're likely to see some interesting structured deals popping up in the infrastructure area very soon in Brazil.

The Latin American commodities are secured by the pledge of receivables, and typically the buyers of these commodities are the largest companies in the world—such as gigantic steel companies in China, Germany and the U.S.

The future of the Latin American structured finance market looks good not just in Brazil but in countries throughout the region. Investors are realizing that there is a remarkable difference between what they've seen with structured deals in the U.S. and the reality of the structured finance market in Latin America. Structured finance has great potential to significantly benefit the economies of Latin America while offering a safe means of investment for those who are willing to give it a chance. ❑

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Private Equity Developments in Brazil, Colombia and Mexico

By The Committee on Inter-American Affairs (New York City Bar Association)

[Editor's Note: This is the second of a two-part series on PE/legal issues in Brazil, Colombia and Mexico. The first part, in the August 2010 edition of *Latin American Law & Business Report*, covered corporate governance regimes, preferred stock provisions, anti-dilution rights, liability and board membership issues, and minority shareholders' rights. This second part covers exit strategies and implementation via tag along, drag along and registration rights; regulatory issues related to formation and operation of funds and foreign investment restrictions; tax issues; and dispute resolution.]

Exit Strategies and Implementation, via Tag Along, Drag Along and Registration Rights

Private equity investors normally seek to maintain their investments for relatively short periods, usually no more than 5 or 6 years, and thus tend to insist on protections of their ability to exit from the portfolio company at the end of the projected period of investment or beforehand if appropriate. Exits may be through an IPO, a sale to a strategic buyer, a sale back to the company or a sale to existing management. To protect their ability to carry out such exits, investors often seek provisions in shareholders' agreements that will enable them to register their shares in a public offering, participate in sales by other shareholders to third parties ("tag along" rights) and require other shareholders to sell their shares to a third party identified by the initiating seller ("drag along" rights). Each of the three countries permits these means to enable a shareholder to carry out its exit strategy, but the usefulness of such methods will of course depend on whether there is an adequate market (in the case of registration rights) or available interested buyers (in the case of tag along and drag along rights).

Brazil

In Brazil, under the LSA, minority shareholders are entitled to tag along rights in a public offering of shares and in the case of a merger. The Novo Mercado requires that each listed company have at least one class of shares with tag along rights for all minorities. Rights of first refusal, tag along and drag along rights and preemptive rights may be established contractually in shareholders' agreements and are theoretically enforceable in court, but judicial precedents have so far been insignificant.

Novo Mercado has been attracting investors and may be close to becoming a real exit possibility for private equity or venture capital funds.

Brazilian companies generally have limited access to traditional sources of financing, such as bank financing or debt markets, and capital costs in Brazil are high. CVM regulations make it difficult to effect a leveraged buy-out (a listed company may not be liable for the debt incurred to finance the transaction) and a listed company may only delist if a tender offer is made at a price that may ultimately be set by minority shareholders. Bovespa does not have the size or depth to support a robust market for IPOs, although the Novo Mercado has been attracting investors and may be close to becoming a real exit possibility for private equity or venture capital funds. In addition, venture capital funds are subject to higher, non-standardized administrative taxes, and often do not have the necessary size and structure to serve as an exit. In some circumstances, companies may be better able to do an IPO outside of Brazil, as indicated in the section on Mexico below. Where an exit is not possible through a leveraged buyout or IPO, investors must focus on the possibility of either a strategic sale (such as a sale to another company in the same industry) or a sale to the other shareholder or shareholders.

Colombia

Tag along rights, although sometimes used in

This report was prepared by the Committee on Inter-American Affairs (Steven M. Kahaner, Chair 2007-2010, smk@marste.com; Hunter T. Carter, Chair 2010-2013, carter.hunter@arentfox.com) of the New York City Bar Association. This standing committee addresses legal and policy issues in Latin America and Canada. The Editor-in-Chief of the report is John Rogers (John.Rogers@strasburger.com). The co-authors of the report include Janine Burman Nicolau, Hunter T. Carter, Steven M. Kahaner, Alexandria C. Nichols, Leonora Olmedo, John Rogers, Clayton Steele and Mark S. Tibberts. The members of the Committee gratefully acknowledge contributions to and comments on the report received from attorneys at the firms Machado Meyer Sendacz Opice (Brazil), Posse Herrera & Ruiz, Prieto & Carrizosa, and Brigard & Urrutia (Colombia), and Forastieri Abogados and SAI Abogados (Mexico).

Colombia (especially when foreign investors are involved), are not generally mandatory for any type of company, but can be implemented through shareholders' agreements (subject to the limitations referred to in the Minority Shareholders' Rights section of this report). Shareholders agreements and by-laws can also include put options, drag along rights and registration rights, and these provisions are recognized by the SFC and enforceable in the courts. As for Registered Companies, tag along rights are only mandatory in certain cases, such as in the context of some types of public tender offers (oferta pública de adquisición or "OPA") or an auction sale (martillo). There is no requirement that a Registered Company have at least one class of shares with tag along rights for all minorities. For shareholders of Registered Companies, tag along rights structured through shareholders' agreements are recognized and enforceable among the parties, but only if such rights are structured in compliance with securities market laws and regulations, including registration and disclosure, as indicated in the Minority Shareholders' Rights section of this report.

The lack of legal rules governing the inclusion of tag along or drag along provisions allow the parties to freely regulate these issues within the law's general framework, but this freedom may lead to deadlocks or enforcement difficulties. Since there is no quick and specifically established mechanism for the enforcement of these provisions, the resolution of disputes or penalties for default are subject to judicial or arbitral proceedings, as applicable. Furthermore, practical implementation of such structures is not well developed, and there are few published judicial or arbitral decisions construing the application thereof.

There are a variety of exit alternatives available. Foreign investment requirements are limited to requiring that the investment be registered and that the registered information be updated on a yearly basis, and do not limit the divestment strategies. The exit strategies generally used by fund managers to exit investments include (i) listing the portfolio company on the stock exchange and carrying out an IPO or creating a secondary market (there are no piggy-back rights in Colombia), although the requirements can be cumbersome, (ii) selling the fund's equity investment to the remaining or initial shareholders or to management in a management buy-out, using put and call rights, and (iii) selling the fund's equity investment to third parties (strategic or non-strategic investors), using tag along and drag along rights. Exchange regulations, however, make it difficult to effect a leveraged buy-out. In addition, debt push-down structures are also difficult to implement. In some circumstances, companies may be better able to do an IPO outside of Colombia, as indicated in the section on Mexico below.

Mexico

Tag along rights are generally recognized but not mandatory in Mexico. By-law provisions as to such rights are likely to be enforceable when they involve SAPIs and SAPIBs, but such enforceability is considerably more difficult in the case of other types of entities, such as SAs and SRLs. Registration rights are common, although judicial enforcement of such provisions may be complicated.

The lack of legal rules governing the inclusion of tag along or drag along provisions allow the parties to freely regulate these issues within the law's general framework, but this freedom may lead to deadlocks or enforcement difficulties.

The common exit options for private equity investments in Mexico are a sale to a third party, a sale to other shareholders, or an IPO, but for practical reasons the most common exit strategy is to sell the assets or stock of the company to a third party in a private sale, sometimes through the exercise of drag along and tag along rights. The LMV allows shareholders of SAPIs and SAPIBs to agree on buy/sell mechanisms that will allow them to sell their interests in the event of a deadlock at the board or shareholder level. Except in the case of SAPIs and SAPIBs, Mexican law specifically prohibits private Mexican companies from redeeming shareholders' stock unless redemption is judicially ordered for the purpose of satisfying debt obligations. An SAB may sell its stock to the general public by listing its shares directly on the Mexican stock exchange (Bolsa Mexicana de Valores, or "BMV") in an IPO. However, public stock markets in Mexico remain small by U.S. standards and can be illiquid. An SAB may also sell its stock directly or by listing American Depositary Receipts on a U.S. stock exchange, on NASDAQ, or in the over-the-counter or "pink sheet" markets. Mexican companies can also pursue a private placement in the United States under Section 4(2) of the Securities Act (most commonly via Regulation D).

Summary Comparison

Because local markets lack sufficient size or depth to support IPOs, exit strategies in all three countries tend to rely more on the possibilities of transferring shares to other shareholders or to third parties (including strategic buyers) in negotiated sales, which can depend on the effectiveness of tag along and drag along rights as well as puts and calls. In all three countries, shareholders can seek the protection of such rights through negotiating for inclusion of appropriate provisions in the company's

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by-laws and/or in shareholders' agreements, but such provisions are not mandatory except for tag along rights in the case of publicly-traded companies in Brazil.

Regulatory Issues: Fund Formation/Fund Operation and Restrictions On Foreign Investment In Funds

To a growing degree, investment in Latin America by private equity funds based in the United States and Europe is being supplemented by investment through locally-based private equity funds. This is particularly true in Brazil and Colombia, where local sources of capital are being directed to investments in local companies, but not so prevalent in Mexico (although the recent introduction of CKDs described below may change this situation). Local funds often have the advantage of being more familiar with local companies, and may be less complicated for local investors from a tax perspective.

Brazil

Brazil has a regulatory regime that is relatively friendly to private equity investment, which has helped to significantly increase private equity activity in recent years. As described below, however, a number of issues still exist.

The two most commonly used vehicles for private equity investments in Brazil are Fundos de Investimento em Participação ("FIPs") and sociedades limitadas. While both have made investing in private equity funds more accessible, FIPs in particular have become the preferred form.

FIPs are closed-end investment funds permitted to invest in public or private corporations. They benefit investors by allowing investments in private entities to be exempt from both capital gains and distribution taxes. Additionally, they permit the netting of gains and losses among investments in the same fund. FIPs are generally not constrained as to the size of their target companies and have the ability to control targets through majority ownership or contractual agreements. FIPs may not make direct investments outside of Brazil or invest in real estate. Sociedadas limitadas provide their shareholders with limited liability to the extent of subscribed and paid-up capital and are not required to publish their financial statements. Any sociedade limitada must be comprised of at least two equity shareholders, which may be individuals or legal entities (domestic or foreign). Non-resident equity holders need to appoint a Brazilian resident individual to represent them locally. Furthermore, sociedades limitadas have no minimum capital requirement.

FIPs (but not sociedades limitadas) must register with the CVM, and this registration process can be cumbersome. FIPs are only accessible to qualified investors, which include financial institutions, insurance companies, investment funds, portfolio administrators, and securities consultants, as well as individuals or legal entities that hold financial investments in an amount exceeding a specified threshold. No simple online registration process exists for FIPs. Additionally, the central bank in Brazil requires the registration of all of the investments made by foreign investors, whether through FIPs or sociedades limitadas. While Brazil has made great strides in enabling equity investments, the somewhat difficult registration process as well as problems associated with processing foreign exchange flows make investing logistically difficult, especially for foreign investors.

Negotiations between private investors and various funds are severely hindered in Brazil due to the lack of valuation guidelines needed to create a framework for valuing investments and so provide consistency within the private equity industry.

Negotiations between private investors and various funds are severely hindered in Brazil due to the lack of valuation guidelines needed to create a framework for valuing investments and so provide consistency within the private equity industry. Intellectual property rights present an additional issue because a lack of transfer rules makes registration and enforcement quite difficult.

Both insurance companies and pension funds are major sources of private equity funding in Brazil, but these institutional investors are under certain restrictions which limit their ability to participate. Such restrictions include Brazil's variable income rules, which specify that no more than 50% of a pension fund may be allocated to variable income. Pension funds are also limited to investing no more than 20% of the entirety of their respective funds under investment ("reserves") in private equity and cannot invest in any private equity funds domiciled outside of Brazil. Open pension funds may invest up to 60% of their reserves in stocks while insurance companies may invest up to 50% of their reserves in stocks and other variable income instruments. Pension funds generally participate in Brazilian private equity investments more often than insurance companies. Many pension funds investing in private equity also insist on participating on the investment committees of the funds in which they have invested.

Foreign investors also face obstacles. All foreign investments in Brazilian companies must be registered with the Central Bank Electronic Registration System. Without proper registration, the investor's ability to repatriate funds and receive dividends will be severely

hindered. While investors must pay the increased transaction costs associated with this registration, there is no requirement that they maintain a permanent establishment in Brazil in order to invest in a Brazilian company. Additionally, there are no restrictions on the amount of the foreign investment, except for certain regulated industries such as nuclear energy, health services, postal services, airlines and media. Compared to other Latin American countries, such as Argentina and Mexico, Brazil has fewer restrictions on foreign investments in private equity funds. However, foreign investors will likely face increased transaction costs due to the registration requirements associated with these types of investments.

Colombia

In Colombia, regulation of private equity funds is focused on those which are formed as Fondos de Capital Privado ("FCPs"), which are closed pooled funds (carteras colectivas cerradas or "Pooled Funds") in which 2/3 of the contributions are invested in assets or economic rights other than publicly traded securities registered with the National Registry of Securities and Issuers (Registro Nacional de Valores y Emisores).

The formation and management of FCPs are subject to Decree 2175. FCPs are also subject to administrative regulations issued by the Central Bank with respect to currency and foreign exchange matters, as well as administrative and technical regulations issued by specific supervisory governmental agencies. SFC regulations address more specific issues for FCPs, such as fund formation monitoring, fund portfolio and individual share valuation methodologies and reporting standards, management and compliance issues and profitability disclosure rules. The SFC also cooperates with the Autorregulador del Mercado de Valores ("AMV"), a self-regulating organization which acts to maintain stability and integrity in the markets and to protect investor interests.

Decree 2175 classifies categories of Pooled Funds based in part on requirements for the redemption of shares. For example, it provides for (i) open Pooled Funds without restrictions on redemption, (ii) open Pooled Funds with penalties for early redemption, (iii) staggered Pooled Funds (cartera colectiva escalonada) in which shares may only be redeemed once a specified maturity has been reached, and (iv) closed Pooled Funds where shares may only be redeemed upon expiration of the fund's term unless partial and advanced redemptions are (a) required by law, or (b) required to distribute the appreciated value of shares. It also classifies categories of Pooled Funds with regard to the underlying asset and transactions managed by such funds, for example, (i) real estate, (ii) margin (only brokers and trust companies are authorized to manage such funds), (iii) speculative (with minimum investment size restrictions), (iv) index funds, and (v) FCPs. Decree 2175 does not, however, preclude the establishment of funds structured with other characteristics (i.e., funds of funds), if authorized by the SFC.

An FCP must be formed as a special purpose vehicle that does not have legal personality and that is administered by a trust company (Sociedad Fiduciaria), a broker (Sociedad Comisionista de Bolsa) or an investment company (Sociedad Administradora de Inversión), such companies being collectively called "Authorized Companies"). FCPs are not eligible investments for pension funds. As closed Pooled Funds, FCPs' participation units may only be redeemed upon expiration of the fund's term unless (a) the redemption is partial and in advance, or (b) there has been an appreciation in the value of the units of participation.

Compared to other Latin American countries, such as Argentina and Mexico, Brazil has fewer restrictions on foreign investments in private equity funds. However, foreign investors will likely face increased transaction costs due to the registration requirements associated with these types of investments.

FCPs must be managed by either a manager designated by the Authorized Company or by a professional manager (Gestor Profesional or "GP") hired by the Authorized Company. Decree 2175 requires that the GP be an expert in the management of investment portfolios or the type of assets in which the fund invests. Authorized Companies that manage FCPs through a manager who they designate directly can only designate managers who are registered with the Registro Nacional de Profesionales del Mercado de Valores (RNPMV) and who maintain certifications with AMV. In order for the FCP to receive investments from pension or severance funds, it must designate a GP who has had at least 5 years of experience in managing (i) private equity funds, or (ii) assets of the class targeted by the fund within or outside of Colombia. If the GP is a legal entity, such requirement can be satisfied by its legal representative or by its parent company, as applicable.

As noted in the Liability Of Managers, Directors and Shareholders; Board Membership section of this report, Articles 54 to 60 of Decree 2175 provide that provisions of the Code of Commerce applicable to sociedades anónimas apply to FCPs as well. As a result, participation units in FCPs, directors and investment committee members are subject to a regime similar to that applicable to shareholders

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and directors of companies. Also, the rules on managers' liabilities, board membership and shareholder rights that are contained in Law 222 also apply to FCPs. Although this law refers specifically to managers' liabilities in the context of the different forms of "companies" existing in Colombia, they are also applicable to FCPs, as specifically set forth in Decree 2175.

In general, the formation of an FCP in Colombia is relatively simple. Once the Authorized Company and the manager or GP have been appointed, the Authorized Company must file the proposed Placement Rules (Reglamento) of the FCP with the SFC for informational purposes. Even though the SFC's prior approval is not an operational requirement, it is advisable that the FCP organizers take into account any comments the SFC and potential institutional investors may make regarding the proposed Placement Rules or other aspects of the FCP. The FCP can commence operations within ten days after the filing of its Placement Rules with the SFC. Thereafter, the Authorized Company will be required to comply with certain obligations such as periodic disclosure of information to investors and to the SFC, delivery of periodic valuation and profitability reports, and responding to any requests by the SFC for additional information.

Decree 2080, adopted in 2000, requires that foreign private capital invested from abroad in Colombia must be channeled through the foreign exchange market, as foreign direct investment or as portfolio investment. Investment by a foreign investor, whether or not it is a foreign private equity fund, in an FCP in Colombia is deemed to be foreign direct investment, as is investment by a foreign fund directly in a Colombian company, and in each case such investment must be routed through a foreign exchange intermediary to the corresponding FCP or company. Article 6 of Decree 2080 provides that foreign investment is permitted in most sectors of the Colombian economy. The main exceptions are: (i) the sectors in which foreign investment is prohibited, namely defense and national security activities and the processing, transportation and disposal of toxic, hazardous or radioactive waste originating outside of Colombia; (ii) a few sectors where there are percentage limitations, notably telecommunications; and (iv) a few sectors where prior government authorizations are required, notably financial services.

For a Colombian pension fund to invest in a private equity fund formed outside of Colombia (a Fondo de Capital Privado Constituido en el Exterior or "FCPE"), the FCPE must satisfy the following additional restrictions imposed by the SFC: (i) at least one of the following entities must be incorporated in an investment grade jurisdiction: (a) the special purpose entity through which the FCPE was formed, (b) the FCPE's manager, parent company or affiliates, or (c) the FCPE's professional manager, (ii) the FCPE or its manager (or affiliates) or general partner (or general partner's affiliates) must have invested or managed qualified assets of at least US$1 billion; (iii) the FCPE's manager, whether an individual or entity, must have at least 5 years of experience in the management of FCPs or FCPEs or in the management of the underlying assets of FCPs or FCPEs (if the FCPE's manager is an entity, the 5 year experience requirement can be satisfied by any legal representative thereof); and (iv) the FCPE's private placement memorandum must identify the fund's investment targets, investment policies, risk management and internal corporate governance controls.

Mexico has not been an attractive jurisdiction in which to create or form private equity funds, partly due to a lack of appropriate vehicles and mechanisms and partly due to a lack of tax incentives.

Mexico

Mexico has not been an attractive jurisdiction in which to create or form private equity funds, partly due to a lack of appropriate vehicles and mechanisms and partly due to a lack of tax incentives. Mexico has not yet developed a strong or compelling regulatory structure that would allow the private equity industry to fully develop, and investors do not consider the available vehicles to be appealing or trustworthy.

During the 1990's, new legislation permitted the formation of a new type of capital investment entity called the Sociedad de Inversión de Capital (SINCA), an open-end private equity fund regulated by the CNBV. Unfortunately, SINCAs have not prospered due to excessive regulation which restricts the scope of their investments as well as their funding and management.

More recent legislation has introduced additional types of investment vehicles. In 2005, Banco de México (Mexico's Central Bank) promulgated rules permitting the creation of vehicles called Private Equity Investment Trusts (Fideicomisos de Inversión de Capital Privado (FICAP)) regulated by the Income Tax Law. The FICAP was designed as an open trust, which may continuously raise funds and close multiple deals. From a corporate and tax perspective, FICAPs are structured like a U.S. limited partnership. However, FICAPs are still problematic for investors because of (i) restrictions on the investment period of the trust (80% of its funds must be invested one year after closing), and (ii) restrictions on the reinvestment of funds (the trust must distribute its income immediately after selling any portion of its portfolio).

In July 2009, the CNBV issued new regulations permitting the issuance of Development Capital Bonds (Certificados de Capital de Desarrollo or "CKDs"), which may be listed on the Mexican Stock Exchange for the purpose of attracting investments in infrastructure, communications, energy, commercial harbors and certain private real estate projects, among others. CKDs are a new vehicle that can provide financing and investing in infrastructure projects and private equity investments in specific sectors. The new regulations set forth corporate governance rules applicable to issuers of CKDs that are similar to those applicable to SABs. Mexican pension funds are permitted to invest in CKDs. They are not permitted to invest in other private equity fund structures, whether organized in Mexico or in a foreign jurisdiction.

Recently, Mexico's largest development banks - National Financiera S.N.C. (Nafin), Banco Nacional de Obras y Servicios Públicos, S.N.C. (Banobras) and Banco Nacional de Comercio Exterior, S.N.C. (Bancomext) - and FOCIR (a Federal government trust fund) launched a fund of funds (informally called the "Fondo de Fondos") which aims, among other things, to provide long-term financial resources via private equity and venture capital funds to Mexican companies, promote a venture capital culture and contribute to establishing the conditions necessary to develop the market by increasing the amount of resources available. The Fondo de Fondos has already funded several private equity funds in Mexico as part of an economic support and development plan. The Fondo de Fondos' investment policies include investing in private equity funds which have a minimum target capital of US$12 million and to hold a minority share of up to 35% and a maximum of US$30 million of the fund's capital.

Apart from the funds formed in Mexico, there are a number of foreign-based funds, mainly investment management firms managed in the United States and in other countries, that have made investments in Mexican companies. Some of theses funds are created as specialized funds limited to Mexico, and the portfolio companies are managed locally. Some sectors of the Mexican economy are subject to restrictions on foreign investment, such as telecommunications, air transport, navigation in coastal waters (cabotage) and the oil and gas industry.

Summary Comparison

Of the three countries, Brazil and Colombia have more investor-friendly regulatory schemes with regard to private equity investments. While some hurdles do exist in Brazil, such as cumbersome registration processes and higher costs for foreign investors, the creation of FIPs and sociedades limitadas have made investment opportunities in Brazilian private equity funds much more accessible. Colombia's regulations are perhaps broader and more flexible, and allow for the establishment of a wide variety of FCPs, and FCP formation is relatively simple and rapid, but investors must comply with various SFC requirements as to the qualifications of fund managers, and as well as additional SFC restrictions placed on foreign private capital invested through FCPEs, including requirements that investments originate from an investment grade jurisdiction. To complicate matters, certain aspects of Pooled Fund regulation in Colombia have not been clarified by the SFC. Mexico has implemented the least investor-friendly regulatory scheme, characterized by a lack of both investment vehicles and tax incentives. Most attempts to create investment entities in Mexico have failed due to excessive regulation.

Brazil has taken steps to encourage investment in private equity and venture capital through codification of certain tax incentives.

Pension funds in Brazil and Colombia are permitted to invest in certain types of private equity funds, including, in the case of Colombian FCPEs, funds based outside of the country. In Mexico, pension funds are permitted to invest in CKDs but in no other type of private equity structure, whether based within or outside of Mexico.

Tax Issues

There are a variety of tax issues that private equity investors must address before deciding to make an investment in a particular company or fund, including: (i) tax rates on corporate profits in the relevant jurisdictions, (ii) the applicable rate at which capital gains are taxed, (iii) the presence or absence of tax incentives, and (iv) whether there is any treaty in force between the home country of a foreign investor and the country where the relevant company or fund is formed that would minimize double taxation on dividends and distributions payable to such investors, as well as on capital gains. Brazil, Colombia and Mexico have taken different approaches to these issues.

Brazil

Brazil has taken steps to encourage investment in private equity and venture capital through codification of certain tax incentives. Favorable measures include a lower rate of taxation applicable to private equity investments, tax incentives for foreign direct investment, and tax benefits made available to public entities that invest in private sector research and development. Further, dividends from Brazilian companies are not subject to tax or withholding tax regardless of the residence of the investor.

In recent years, Brazil has lowered certain tax rates. As of January 2005, Brazil reduced the rate of income and capital gains tax on domestic investment in regulated

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private equity and venture capital funds from 20% to 15%, with a lobby working towards a further reduction to a 10% rate. These rates are attractive, especially as compared to the 34% effective rate on corporate income.

In addition, Brazil's tax incentives for foreign investment in private equity and venture capital funds reduce, and can sometimes eliminate, any related taxes for foreign investors. Foreign investment in regulated private equity and venture capital funds is generally exempt from income and capital gains tax if (i) the investment does not come from entities registered in tax havens, (ii) the investor does not hold more than 40% of the investment funds, and (iii) each fund in which the foreign investment is made does not hold more than 5% of its equity in bonds other than Brazilian public bonds.

Nevertheless, while Brazil has moved towards a more investor-friendly tax regime, there are still some issues of which an investor should be aware. For instance, double taxation is more easily avoided by foreigners, but domestic investors must carefully structure transactions in order to take advantage of tax benefits discussed above. In addition, Brazil changes its rules on tax domiciles often and sometimes unpredictably. These changes can make the rate of taxation or the existence of an exemption difficult to determine. As a result, an investor may unwittingly find itself in a locally classified tax haven where capital gains are not exempt and have instead been increased from a 15% to a 20% rate.

Colombia

Colombia has also enacted a number of tax rules to encourage investment in private equity and hedge funds. Under Colombian law, foreign investment funds themselves are not taxpayers. In addition, private equity funds organized as FCPs are generally disregarded for tax purposes, and are therefore not themselves subject to income or capital gains tax. As a result, FCPs may be considered tax-transparent or pass-through vehicles. Investors in FCPs are taxed on the income of the FCP as if they had received the income directly. For such purposes, capital gains are generally assessed at the normal corporate income tax rate of 33%, except for certain special situations in which capital gains tax treatment is different, notably: (i) with the sale in any fiscal year of less than 10% of a company's shares listed on the Colombian Stock Exchange, in which case no capital gains tax is payable, and (ii) with the sale of real property in specified cities (including Bogotá), in which the book value for purposes of the capital gains tax is deemed to be the self-appraised value for real estate municipal tax purposes. On the other hand, no tax deduction can be claimed for losses from the sale of any kind of corporate shares. A new equity tax on companies was recently approved and will become effective as of January 1, 2011, but as in the case of other taxes, FCPs are disregarded for purposes of such tax.

Colombia is also party to various agreements that enable foreign investors from certain countries (currently Perú, Ecuador, Bolivia, Chile and Spain) to avoid double taxation on income accruing from investments in Colombia, and is negotiating or in the process of approving similar agreements with additional countries, including Switzerland, Mexico, Canada and South Korea. Finally, under a special incentive, investment (whether made by foreign or domestic investors) in real productive assets generates a tax deduction (equivalent to 30% - recently reduced from 40% - of the initial investment, after taking into account normal depreciation of the related assets). Commercial profits generated by this tax benefit can be distributed abroad without applying any tax in Colombia. Moreover, tax losses may be deducted and carried forward without any time limitation.

Mexico has also taken some steps to encourage investment in private equity and venture capital.

FCPs may invest in companies located in any type of Free Trade Zone in Colombia, either as an industrial user or as an operator, and in such cases the companies' profits distributed to the FCPs as dividends will be subject to a corporate income tax rate of 15% instead of the otherwise applicable rate of 33%. However, the 30% special tax deduction mentioned in the preceding paragraph cannot be utilized in such cases.

Interest paid by a Colombian entity or FCP to foreign creditors is generally deemed to be foreign (non-Colombian) source income and thus is not subject to income tax withholding in Colombia. There is no longer any remittance tax imposed on the transfer of Colombian-source income to investors located abroad.

Mexico

Mexico has also taken some steps to encourage investment in private equity and venture capital. Principally, dividends paid to both residents and non-residents are generally not subject to withholding tax, and are not otherwise subject to tax if the dividend is paid from profits on which the Mexican company has paid its own income tax. On the other hand, under rules of the SHCP, pass-through treatment for Mexican income tax purposes is not possible unless the foreign shareholder is not only tax transparent but also treated as having no legal personality. In this regard, a limited partnership formed under the law of certain Canadian provinces can satisfy the latter requirement because it may be deemed to lack legal personality under the laws of such provinces, but it does not appear that a limited partnership organized

under the laws of any state of the United States could do so. The SHCP seems determined to continue this rule, which means that foreign private equity investment in Mexico has been largely flowing through Canadian limited partnerships.

Mexican-sourced interest paid to a foreign investor is subject to withholding tax. The withholding tax rate on interest generally can be as high as 30%, but depends on a number of factors. In addition, the applicable withholding tax rate on interest may be reduced for certain categories of interest. For example, interest paid to a foreign financial institution registered with the SHCP is taxed at the rate of 4.9%. In certain circumstances, interest paid to residents of tax havens that are not financial institutions is subject to withholding at the rate of 40% (but SHCP rules and a recent Supreme Court decision tend to limit the 40% withholding to transactions between related parties).

The taxation of capital gains in Mexico may be a deterrent to investors, as capital gains from the sale of stock in a Mexican company are generally subject to tax at 25%. The rate of tax can be 40% if the selling foreign investor is a resident of a low-tax jurisdiction, subject to the limitation referred to in the preceding paragraph. These rates apply to any sale of equity in a Mexican entity, whether it is an SRL, SA, SAPI, or SAPIB, but not to a sale of publicly traded shares in an SAB on a recognized stock market, which sales are generally exempt from tax. Capital gains tax rates are either based on the price paid for the equity interest or on the actual capital gain as determined through a certified public accountant's tax report prepared in accordance with certain specific requirements. The impact of capital gains taxation with respect to foreign investors may be mitigated by double-taxation conventions between Mexico and the investors' home countries (Mexico has signed such conventions with around 40 countries to date).

Mexico has also enacted special incentives for tax-exempt foreign pension and benefit funds. Such funds may be eligible for an exemption from Mexican withholding taxes on interest, capital gains and rent, if they are tax exempt in their home jurisdiction and make appropriate registrations with the Mexican government. Tax incentives have also been put in place for equity or debt investments in venture capital funds (Fideicomisos de Capital de Riesgo) but the attractiveness of such funds is limited by what are viewed to be the insufficient benefits thereof and the rigid rules established for the operation of such funds.

Summary Comparison

Brazil, Colombia, and Mexico have all taken steps to encourage investments in private equity and other funds through the use of various tax incentives. The common incentives in all three countries include lowering tax rates and eliminating taxes for specific types of investments. Investors in all three countries must also be aware of potential tax problems and how to avoid them. While Brazil has lowered rates and made certain exemptions for foreign investors, investments must be carefully structured to avoid unfavorable results, such as double taxation and unpredictable tax domiciles. In Colombia, the development of FCPs successfully promote foreign investments but investors need to keep in mind that FCP income is directly taxable. Mexico has taken steps by eliminating withholding taxes on dividends paid to residents and non-residents, but investors must adhere to the SHCP rules in order to take advantage of pass-through tax treatment. Investors should obtain the advice of qualified counsel in order to avoid these problems.

Brazil, Colombia, and Mexico have all taken steps to encourage investments in private equity and other funds through the use of various tax incentives. The common incentives in all three countries include lowering tax rates and eliminating taxes for specific types of investments.

Dispute Resolution

Litigation is a fact of business life; market forces alone do not entirely govern private equity/venture capital transactions such as fund formation, asset acquisition, manager compensation, and exits. Arbitration is sometimes chosen as an alternative to litigation because of concerns over the efficacy of the applicable judicial systems in resolving disputes. This section first looks at investor perceptions of dispute resolution in Brazil, Colombia and Mexico in the context of overall concerns about how well investor interests are protected in such countries, and then considers the use of local and international arbitration with respect to private equity disputes affecting the three countries, including how arbitration may apply to fund manager and investor relations, fund relations with portfolio sellers, portfolio company operations, and bankruptcy.

A. Perceptions of Latin American Dispute Resolution: Brazil, Colombia, and Mexico

In considering the private equity "gap" that affects Latin American markets, it is important to know how market perceptions of dispute resolution play a role. The Latin America Venture Capital Association ("LAVCA") releases an annual scorecard ranking Latin American countries with respect to various factors that can affect private equity investment decisions. On its most recent

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scorecard, Brazil, Colombia and Mexico are ranked 3 on a scale of 4 (4 being the highest ranking) as to "protection of minority shareholders" and "corporate governance requirements." Each country ranked 2 on a scale of 4 with respect to the "strength of the judicial system." When it comes to bankruptcy procedures, LAVCA ranks Brazil 3 on a scale of 4, and Colombia and Mexico 2 on a scale of 4. Each of the three countries in our study faces very negative worldwide perceptions about corruption in their legal systems, scoring 1 on a scale of 4.[1]

A broader comparison of these issues is found in The World Bank's "Doing Business 2010" report. Among the factors it measures are "protecting investors" (liability for self-dealing, shareholders' ability to sue officers and directors for misconduct), "enforcing contracts" (time, cost, and number of procedures involved from the moment a plaintiff files a hypothetical collections lawsuit until actual payment), and "closing a business" (time and cost required to resolve bankruptcies).

In the World Bank report's overall ranking, Mexico (no. 49) outranks Colombia (no. 63) but not by as much as both outrank Brazil (no. 101). Brazil has low marks across the board, ranking 73rd worldwide for protecting investors, 100th for enforcing contracts, and 131st for closing a business. Colombia surprises with a stunning 5th for protecting investors, and a quite respectable 32nd for closing a business, but 152nd for enforcing contracts. Mexico ranks 41st for protecting investors, 81st for enforcing contracts, and a very strong 24th for closing businesses (which seems to conflict with its very low LAVCA ranking in this regard). The World Bank's methodology does not include "enforcing contracts" by the use of commercial arbitration, which has effectively replaced the courts for many commercial matters.

B. Arbitration

Surveys such as those mentioned above reveal perceptions that there are significant difficulties in enforcing contracts in the courts of Brazil, Colombia and Mexico. These perceptions lead many private equity fund managers and investors to choose international arbitration for the resolution of disputes, or to create offshore structures. Arbitration provides several advantages over local legal systems. Arbitration is usually faster, arbitrators are often better decision-makers, with more time and attention available to understand the complex issues and to apply commercial standards, and arbitration is usually confidential. On the other hand, arbitration is increasingly adopting processes similar to those used in litigation, and the absence of an appeal right and relaxed expectations of adherence to precedent generally make arbitration more unpredictable. Arbitration may be more appropriate in some cases (such as in striking compromises, approximating damages) but less advisable in others (such as the strict enforcement of written obligations). Even in the most advanced economies, arbitration is superior to litigation where the alternative is a poorly-rated court system, or where confidentiality is of key importance.

Arbitration may be domestic or international. All three countries permit enforcement of foreign arbitral awards, though they vary in restricting foreign arbitration of certain types of disputes.

Arbitration may not be available for some important types of disputes. In the private equity context, the arbitration of provisions of the shareholders' agreement or investment agreement may be limited by legislation that requires disputes over by-laws to be litigated in courts rather than through the arbitration process. Under Brazilian and Colombian law, however, if all parties to a dispute have executed an arbitration agreement and the bylaw dispute falls within the language of the arbitration agreement, the dispute is almost always permitted to be resolved through binding arbitration. Under Mexican law, the by-laws of a SAPI or SAPIB can generally be subject to arbitration but other corporate entities would be subject to constraints based on Civil Code restrictions on the ability of shareholders to agree in advance as to how their votes will be cast at shareholders' meetings. Otherwise, a shareholders' agreement can be subject to arbitration regardless of the type of entity which is involved.

Arbitration may be domestic or international. All three countries permit enforcement of foreign arbitral awards, though they vary in restricting foreign arbitration of certain types of disputes. Foreign and domestic arbitration awards alike must be presented to a court where the relevant assets are located in order to reach those assets. Thus, the location of the assets backing a contractual obligation is the forum whose laws matter most to the enforcement process. These may not be in the country where the portfolio company is domiciled.

Arbitration is a limited option when an injunction or specific enforcement of a contractual provision is required, such as to enforce drag along/tag along rights, or to block a sale or other corporate action requiring investor approval that management fails to gain. Arbitrators may adopt interim measures (claim registrations and seizures) in disputes regarding property rights, but in Colombia they may not issue preliminary awards or interim relief. This is clearly a deficiency that should be remedied so that local legal systems, widely perceived to be slow, expensive, uncertain, and perhaps corrupt, are not the only way to secure provisional remedies.

A variety of interim awards and relief can be obtained in both Brazil and Mexico, including orders to compel the production of financial statements and other documents.

C. Offshore Structures

Where there are insurmountable concerns about local legal systems or enforcement of arbitral awards, funds respond by structuring investments through offshore entities, choosing jurisdictions whose courts or arbitral forums are accepted by all parties and relevant to the execution of the ultimate award. The offshore entity is usually structured to own all or substantially all of the equity in the local company, in order that judgments or arbitral awards can be enforced – in most respects – in disputes among managers, general partners, and limited partners outside of the local country. Offshore entities may also offer some advantages with respect to particular concerns of corporate governance, protection of minority investors and other protections familiar to the global investment community, though in each of these categories, Brazil, Colombia, and Mexico receive relatively high marks demonstrating significant improvement (see Section A above).

Offshore entities can create tax complications. Examples include those resulting from local investors having to invest abroad or when managers extend equity to sellers of local portfolio companies as part of the consideration for an offshore purchase. Similarly, the offshore structure is less useful where local general or limited partners, or managers, that contribute to the fund's attractiveness and performance, cannot agree to them. And, offshore equity entities provide no remedy with respect to acquisition/disposition or operations disputes.

D. Fund Relations with Portfolio Sellers

Portfolio company sellers (or buyers) may act strategically or tactically in ways that breach covenants, representations and warranties, or other market norms. Actions against them must usually be swift and will therefore often be brought before domestic courts or arbitral tribunals. If a local player is perceived to have some advantage in domestic courts or arbitral tribunals, any such advantage can be offset by selecting foreign judicial or arbitral forums. Parties may, where appropriate, enter into arbitration agreements in advance of consummation of an acquisition and may also provide for arbitration in the acquisition agreement. Because enforcement of the award would ordinarily require execution on assets through local courts, most acquisitions and dispositions have indemnification reserves subject to disposition by the arbitrators.

E. Portfolio Company Operations

Fund profitability is affected by operations, which are in turn affected by the expense and reliability of the local legal systems. Operations of portfolio companies are no less subject to employee or commercial litigation simply because the company happens to be in a private equity portfolio. Customs and tax disputes, employment matters, environmental regulation, and the like have significant impacts on the attractiveness of the acquisition to foreign investors, which means that it is quite important for international investors to understand the operation of domestic dispute resolution systems. Funds can compensate for some "foreign-owner" disadvantages through reliance upon local participants such as co-managers or through reliance upon local arbitration to the extent available.

All three countries have placed substantial emphasis on improving corporate governance standards, although such standards are generally still voluntary and investors should ensure that the corporate by-laws and/or shareholders' agreements establish the standards they deem important.

F. Bankruptcy And Restructuring

As the recent worldwide recession demonstrates, unforeseen market circumstances can drive parties into unanticipated disputes and dispute resolution processes, and financial restructuring or liquidation cannot be systematically avoided. Portfolio companies may have to restructure, investors may file for protection from creditors, and even funds may seek restructurings. As discussed more fully in Section A above, the LAVCA scorecard rankings on business-termination and bankruptcy processes suggest that there have been significant improvements in restructuring law and systems in each of the three countries studied, demonstrating that these systems should not pose substantial hurdles to international private equity investors.

Conclusions

Brazil, Colombia and Mexico have all made great strides in the last few years to improve the legal environment affecting private equity investment in most of the areas reviewed above. In all three countries, however, further improvements will be needed in order for private equity to reach its maximum effectiveness as a driver of economic growth.

All three countries have placed substantial emphasis on improving corporate governance standards, although

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such standards are generally still voluntary and investors should ensure that the corporate by-laws and/or shareholders' agreements establish the standards they deem important. Some types of entities are more attractive and flexible in this regard, such as the SAS in Colombia and the SAPI in Mexico, than are the more traditional corporate forms. The newer types of entities are also more capable of providing for the most attractive forms of preferred stock and for protection of minority shareholders' rights. Some types of anti-dilution protection are mandatory, through statutory preemptive rights, while others, such as first refusal rights, must be provided for in optional provisions of the by-laws and the shareholders' agreement. In general, while some protections are mandatory, most must be negotiated by the parties through specific provisions of the by-laws and or the applicable shareholders' agreement.

Tax and regulatory regimes have become more favorable to investors but significant challenges remain in this area, particularly in Mexico, which has not kept pace with the changes in the other countries. Foreign investors in general are faced with a few special hurdles not applicable to local investors (except in the dwindling number of sectors subject to foreign investment restrictions, where in some areas foreign investment is prohibited entirely).

Investors' main concerns appear to focus on the reliability of the legal and judicial systems in the three countries. For this reason, they have turned to arbitration as the preferred method for resolving disputes. They have also utilized offshore investment vehicles whose management and operations are not subject to local law and enforcement. This leads to corporate structures that are often overly complex in relation to the size of a projected investment, which increases transaction costs and discourages smaller investments that in the aggregate could represent a substantial contributor to economic growth. In the long run, what will be needed to ensure broad-based and sustained growth - not only in the private equity area but also with other forms of private investment - will be stronger and more efficient judicial systems, more transparent legal processes and a substantial reduction in corruption at all levels. ❑

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1 LAVCA says Brazil's strengths include favorable laws relating to fund formation and operation, and quality accounting standards, while overcoming perceived corruption and achieving enforcement of intellectual property rights continue to be challenging. Colombia's strengths include improved minority shareholders rights and corporate governance, while its perceived corruption and the weakness of the local judicial system still pose a problem. Mexico's strengths are corporate governance and protection of minority investors' rights, while it still faces challenges pertaining to control of the drug trade and laws for fund activity and bankruptcy procedures.

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Title Insurance to Minimize Brazilian Real Estate Title Risk

By Jonathan E. Kellner (Skadden, Arps, Slate, Meager & Flom LLP) and Zachary S. Klughaupt, Esq.

Despite the remarkable success of the Brazilian economy in recent years, particularly in the agricultural sector, the land registration system in Brazil continues to create uncertainty for rural operators and real estate investors, particularly in the less developed regions of the country. These regions are known for ambiguous, contradictory and imprecise official land records, which make it difficult for a purchaser of agricultural, coastal, forestry or other property to be certain of actually owning clean title on the property for which it paid and increases the likelihood that third parties could claim ownership rights on the land.[1] The claims often take the form of boundary disputes, assertions of unrecorded possessory, marital or hereditary rights on the real property, claims based on competing entries in the land registry or the existence of liens on the property.[2] Property sales have been delayed because the seller could not establish valid title to the property, and in one case a group of American investors were forced to exit their investment at a substantial discount because competing claims to the land needed to be settled in order for the land to be sold.

Outright fraud, forgery and corruption can also threaten the land rights of legitimate purchasers. Occurrences of fraud, for example, have resulted in the use of the term *grilagem* in Brazil to describe the process of forging a deed and storing it in a box of crickets ("*grilos*") to make the paper appear older and more authentic.

As with the purchase of property in all countries, purchasers should hire qualified real estate lawyers, preferably counsel from the region where the land is located, to perform careful due diligence of the chain of title. In addition to legal counsel, purchasers should also consider hiring professional surveyors to ensure that a plot's boundaries are consistent with the purchaser's expectations.

Although due diligence can reduce the risk of title problems, no amount of diligence in Brazil can eliminate it. The defense against a third party claim, whether legitimate or not, is likely to be expensive and time-consuming. In addition, fraud and forgeries will not necessarily be detected through legal analysis, and will not be covered by any legal opinion.

Despite the remarkable success of the Brazilian economy in recent years, particularly in the agricultural sector, the land registration system in Brazil continues to create uncertainty for rural operators and real estate investors, particularly in the less developed regions of the country.

Foreign investors in Brazilian real estate can protect themselves from title risk by purchasing an international title insurance policy. Title insurance, which has been offered in the United States for over 130 years, provides a guarantee to the holder of the policy that the covered property is free of liens or defects in title that could impair the purchaser's ability to enjoy all the rights of ownership. If a third party challenges the policyholder's ownership of a covered property, the title insurer will defend the insured against the claim in Brazil or abroad and, to the extent that a third party claim is successful, indemnify the insured for the value of the lost property. Title insurance can also cover fraud, forgery and other contingencies that legal counsel are not capable of eliminating through diligence and the issuance of legal opinions, but it does not cover challenges to title arising from events occurring after the issuance of the policy, such as a change in the law.

Because title insurance is not yet offered by registered insurers in Brazil, it is only available to non-Brazilian companies and individuals. In practical terms, Brazilian farms, tourist developments and other properties that have U.S. limited liability company parents/holding companies, for example, may purchase title insurance policies through their parent entities and Brazilian land funds may purchase the policy through their offshore feeder funds. Non-Brazilian purchasers of carbon offsets that are generated by forests in Brazil can purchase title policies to ensure that the forests underlying the

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carbon credits are actually owned by the entity claiming ownership of (and thus, the ability to preserve) the forests.

The cross border policies are offered by major American title companies, are in English, are governed by the laws of New York and are virtually identical to the American Land Title Association form used in the United States. The policy is generally issued at the time of purchase of the real property. The premium is paid only once, upon issuance of the policy, and provides coverage until the property is transferred. The price varies, depending upon the size and perceived risk of the transaction, but usually will be less than 1% of the amount insured.

Non-Brazilian secured lenders to Brazilian companies can also take advantage of the added security provided by title insurance by purchasing an international lenders' title policy, which, in addition to providing title coverage, guarantees the validity and enforceability of the security interest in the property for the life of the loan. In addition, lenders to Brazilian farms and agricultural companies, whether secured or not, can require borrowers (through their non-Brazilian parents/holding companies) to take out title insurance in conjunction with loans.

As the agricultural sector in Brazil continues to mature, with financing provided by international lenders or through the sale of securities or receivables, title risk becomes an issue for an expanding circle of participants, including lenders, investors and underwriters. Cross border title insurance eliminates the need for each participant in a complex transaction to separately analyze title risk and to factor the risk into its investment decision and valuation. As a result, title insurance can enhance the creditworthiness of real estate investments in Brazil, permitting offshore real estate investors to obtain financing on better terms and at lower rates. ❑

1 The word "title", a term encompassing all rights pertaining to land ownership, should not be confused with the Portuguese "título", which simply means deed.

2 In some areas, duplicate land records are so prevalent that real estate professionals joke about the country having a second floor.

Alternatives to United States Limited Liability Companies on the Brazilian "Tax Blacklist"

By Andrew Walker and Tobias Stirnberg (Milbank, Tweed, Hadley & McCloy LLP)

Introduction

A blacklist recently released by the Brazilian tax authority (SRF No. 1,037/10), targets certain United States limited liability companies. Specifically, the blacklist treats United States limited liability companies owned by nonresidents not subject to United States federal income taxation ("U.S. LLCs") as formed under a "tax favored regime."[1] The blacklist does not treat U.S. LLCs as "low tax entities," avoiding for the present the more punitive Brazilian tax rules that apply to certain tax-haven entities. Nevertheless, Brazilian companies and institutions that have made use of U.S. LLCs in their financing structures need to evaluate the impact of this development for their existing and future financing structures and consider alternatives.

For example, in connection with the financing of aircraft for non-U.S. airlines, U.S. Eximbank generally requires that title to aircraft financed by it be held by an entity outside of the airline's jurisdiction. In the case of a Brazilian airline acquiring a new U.S. manufactured aircraft, until the recent blacklist this requirement of U.S. Eximbank could readily be satisfied by using a tax efficient U.S. entity such as a U.S. LLC.

United States Tax Regime for U.S. LLCs

A U.S. LLC generally is treated as a "flow-through" entity (not taxable at the entity level) and members of a U.S. LLC generally are subject to U.S. taxation on their proportionate share of the U.S. LLC's income. However, members that are not otherwise United States taxpayers will incur United States federal income and withholding taxes only if the LLC is considered to be "doing business" in the United States. Because merely holding shares in a foreign corporation that conducts an active business outside the United States is not itself sufficient to constitute "doing business" in the United States, properly

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structured U.S. LLCs can be used by non-U.S. owners to hold foreign operations without incurring U.S. taxes.

Effect of Tax Favored Regime Status

Because U.S. LLCs now will be treated as entities formed under a "tax favored regime," Brazilian law will limit the advantages of the U.S. LLC in financing structures in two main respects:

(1) Brazilian investors that do business with a U.S. LLC may be subject to tougher "transfer pricing" scrutiny (i.e., the terms of transactions will be more stringently reviewed to ensure potentially taxable value is not being shifted out of the Brazilian tax system).

(2) Brazilian companies that make interest payments to a related U.S. LLC may also be subject to tougher thin capitalization restrictions (i.e., restrictions that limit the ability to deduct debt payments will apply when the company exceeds a 1:3 debt to equity ratio rather than the 2:1 ratio that generally applies).

Replacement Investment Vehicles for the U.S. LLC

The blacklist fails to list a number of other U.S. entities that are taxed under substantially the same United States tax regime as U.S. LLCs and may offer many of the same corporate and legal advantages. These entities may provide a workable alternative to U.S. LLCs in financing structures. A large number of these entities are established under Delaware law, one of the most popular holding company jurisdictions within the United States. However, similar entities with comparable treatment may be formed under the laws of a number of others states.

Delaware Business (Statutory) Trust

Like a U.S. LLC, a Delaware Business Trust is eligible to be taxed on a "flow-through basis" and therefore the trust entity will not incur United States federal income or withholding taxes if properly structured. A Delaware Business Trust offers several other advantages.

The separate legal personality of a Delaware Business Trust is recognized by statute. This avoids the difficulties that may arise when a civil law system confronts an arrangement like a common law trust that is considered distinct for most purposes from the trustee but does not have independent legal personality as an entity. The Delaware Business Trust Act permits the trust agreement of a business trust to establish whatever rights and obligations of the trustees and of the beneficial owners are desired. The voting rights of trustees or beneficial owners, or any class or series thereof, may be expanded, limited or eliminated with respect to virtually any matter relating to the business trust. This flexibility provides an advantage over alternative forms of business organizations and common law trusts. A Delaware Business Trust also is fairly easy to set up and is not expensive to establish or maintain.

Except to the extent otherwise provided in the trust agreement, a Delaware Business Trust is managed by or under the direction of its trustees, who are not liable for the obligations of the business trust.[2] The duties of the trustees may be specified in the trust agreement. The trust agreement also may provide for the appointment of managers, employees or other persons to manage the business trust with the rights, powers and duties set forth. To the extent that trustees or other persons responsible for managing the Delaware Business Trust have duties (including fiduciary duties) and liabilities to the business trust or the beneficial owners, these duties may be expanded or restricted by the trust agreement.

Beneficial owners of a Delaware Business Trust enjoy the same limitation of personal liability as shareholders of a Delaware corporation. Further, the beneficial owners may participate in management and/or effectively control the business trust by directing the trustees without assuming personal liability.

A blacklist recently released by the Brazilian tax authority targets certain United States limited liability companies.

A Delaware Business Trust also has advantages as a "bankruptcy-remote vehicle." No creditor of a beneficial owner has any right to obtain possession of, or otherwise exercise legal or equitable remedies with respect to, the property of the business trust. Thus, creditors of and other interested persons in the business trust have greater protection from the possibility of a partition of trust property or the premature termination of the business trust upon the insolvency or bankruptcy of a beneficial owner than in the case of an ordinary common law trust.

Limited Partnership

Similarly, a Delaware Limited Partnership is eligible to be taxed on a "flow-through basis" and therefore the entity will not incur United States federal income or withholding taxes if properly structured (although it is subject to a small annual state franchise tax). A Delaware Limited Partnership is a partnership formed under the Delaware Revised Uniform Limited Partnership Act having one or more general partners and one or more limited partners. The partnership is recognized as an entity with separate legal personality from its partners.

A Delaware limited partnership can be formed by its partners entering into a limited partnership agreement and filing a separate certificate of limited partnership in the Office of the Delaware Secretary of State. A partnership agreement is not required to be publicly filed or recorded, and the names of the limited partners are not required to

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be set forth in the certificate of limited partnership.

In general, a Delaware limited partnership is managed by its general partner(s) and limited partners are passive investors. A general partner, for most purposes, is personally liable for the debts of the limited partnership, but a limited partner is not personally liable for such debts. It is common to establish a special purpose limited liability vehicle with a very small partnership interest and limited assets to serve as general partner while insulating the ultimate owners from personal liability.

Other Alternatives

There are also other forms of entity that also qualify for "flow through" tax treatment that might be employed, although they are less advantageous for other reasons. A Delaware general partnership is simply an association of two or more persons to carry on a business as co-owners. No formalities are required to create a general partnership. It is prudent, however, to use a written agreement that specifies the respective rights and duties of the partners. The distinguishing features of a general partnership are that each partner is an agent for the partnership with the power to legally bind the partnership and each partner is personally liable for the debts and obligations of the partnership. For non-tax purposes, a Delaware general partnership is a separate entity from its partners, may conduct business, acquire, hold, and dispose of property, and sue and be sued in its name, without the need to join all partners as parties.

Delaware also authorizes a special form of general partnership known as a limited liability partnership. In a limited liability partnership, the partnership is required to register with the Delaware Secretary of State and maintain a specified amount of liability insurance. In return, partners are relieved of personal liability for obligations of the partnership. Partners remain personally liable for their own negligence or misconduct and that of persons under their direct supervision and control. However, this form of entity is more typically used for professional services businesses.

Brazilian companies and institutions that have made use of U.S. LLCs in their financing structures need to evaluate the impact of the new law for their structures and the law may require some restructuring of U.S. participation /holding company structures of Brazilian companies.

Conclusion

Brazilian companies and institutions that have made use of U.S. LLCs in their financing structures need to evaluate the impact of the new law for their structures and the law may require some restructuring of U.S. participation /holding company structures of Brazilian companies. Nevertheless, there remain viable alternatives and in most cases the issues presented by the addition of U.S. LLCs to the backlist can be managed. ❏

1 Based on the specific backlist definition, arguably this would include a U.S. LLC with even one member with a small interest who is not a U.S. taxpayer.

2 The Business Trust Act provides that at least one trustee must be a Delaware resident. This requirement may be satisfied by engaging a trust company with its principal place of business in Delaware.

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The Roaring Colombian Economy

By Walter Molano (BCP Securities, LLC)

Less than a decade ago, Colombia was on the verge of becoming a failed state. During the 1980s and 1990s, the country was systematically destabilized by the well-funded narco-cartels and insurgency movements. Colombia's judiciary came under open attack in 1985, with the armed assault against the Supreme Court—which left almost half of the justices dead, more than 120 casualties and the country's judicial archives in flames. Newspapermen, political candidates and policemen were gunned down with impunity. Car bombs destroyed major urban centers in Bogota, Medellin and Cali. Trade and commercial routes were systematically cut. Hundreds of people were kidnapped, thousands fled the country and many more were extorted and assassinated in what degraded into a bloody civil war. Businessmen and landowners funded private militias to counter the narco-insurgency that was laying waste to the countryside. Unfortunately, many of these groups eventually became armed brigands, who took the law into their own hands and turned against the population at large.

By the end of the 1990s, Colombia was on the verge of collapse. Narco-influence penetrated deep into the political and judiciary systems, the police force was in tatters, and a large swath of the country was officially in the hands of the guerrillas. It was at this time, that the administrations of Presidents Andres Pastrana and Bill Clinton decided to put together a military program, known as Plan Colombia. Under the arrangement, the U.S. government provided $7.5 billion for the acquisition of new helicopters, riverine craft and communications equipment to allow the Colombian military to penetrate deep into the jungle and confront the insurgency. Likewise, the U.S. also provided tactical training to effectively deploy the new equipment in the most effective way. Plan Colombia was a huge success, and it eventually allowed the government to take the initiative against the guerrillas. Fortunately, the transition period has ended, and Colombia is reinvigorated and brimming with life. A tidal wave of capital is pouring in to take advantage of the country's vast natural resources, enormous talent pool and strategic geography. To mark the new beginnings, the country elected a new president, Juan Manuel Santos, who promises to exploit Colombia's full potential and transform it into one of the fastest growing economies of Latin America.

The Colombian economy is roaring, with GDP expected to crest over 5% y/y in 2010. Industrial production surged 8.5% y/y in June, up from 7.5% y/y the month before. Construction is on a tear. The Colombian Construction Chamber of Commerce (Camacol) reported that building permits were up 14% year-to-date. A glimpse out of any high window in Bogota will reveal a veritable forest of cranes and building sites. In addition to home construction, major infrastructure projects are transforming the landscape. A new metro rail system in Bogota, the revitalization of the airport and a series of major highways will improve the economy's level of efficiency and productivity. Billions of dollars are also pouring into major investment projects in energy, mining and agriculture. Ecopetrol is modernizing its refinery at Barrancabermeja. Foreign firms are digging new mines, and farmers from Brazil and Argentina are rushing to take advantage of the fertile llanos that lie just a few hours from Bogota. President Santos promised to raise the country's growth rate to 6% y/y by the end of his term, and it looks like the country is right on track.

A tidal wave of capital is pouring in to take advantage of the country's vast natural resources, enormous talent pool and strategic geography.

President Santos is a brilliant professional, with extensive training abroad and a long series of policy successes. He hails from one of the most prominent families in the country, with extensive ties to business, media and government. Although known for his quick temper, President Santos proved to be more level-headed than his predecessor. His first priority was to stabilize relations with his two neighbours, Venezuela and Ecuador. His efforts to smooth the waters should allow bilateral trade flows to resume, thus providing an additional boost to the Colombian economy. President Santos is also reaching out to Brazil, an important source of foreign investment in the region. Colombia's new approach to Latin America is a clear break from the past, where it was always on bended-knee looking for handouts from Europe and the United States. President Santos understands very well that the next century will be one of ascendency for the hemisphere. Hence, Colombia is best served by refocusing its diplomatic efforts on regional cooperation and integration. Colombian businessmen are heeding the message, as they rush to foster deeper commercial links with counterparts in Peru, Central America and the Caribbean. Therefore, there is a happy jazzy tune humming in the background, as the Santos come marching in. ❑

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Costa Rican Real Estate Development and the Global Financial Crisis

By Alejandro Antillón A. (Pacheco Coto) and Larry B. Pascal (Haynes and Boone, LLP)

Costa Rica experienced an unprecedented growth in the real estate sector, which started in the beginning of 2002 and culminated at the end of 2007. However, the exponential growth in local construction and development of new real estate projects subsequently revealed certain systematic deficiencies and obstacles. Nevertheless, the crisis has resulted in a better understanding of the workings of the applicable governmental agencies and the related proceedings with which a developer has to work to develop a real estate project in the country.

In this article, we will discuss experiences of developers, lawyers, and engineers in their dealings with governmental agencies when developing a real estate project in Costa Rica, focusing on the web of bureaucratic procedures and paperwork, or so-called tramitologia. Likewise, we will briefly describe the system for conveyance of real property under Costa Rican law, with particular focus on the registration system and tax issues arising out of the development of such projects.

By the beginning of the 1990s, Costa Rica had positioned itself as an attractive ecotourism destination. The country is one of the strongest democracies in the region, is a destination of great natural beauty, and is located relatively near the US, where more than 70% of its tourists come from. Moreover, it enjoys one of the highest educational and social standards in the region. These factors, combined with a protective environmental policy, have made Costa Rica an attractive ecotourism destination.

In 2002, Costa Rica started to experience strong growth in the real estate sector, driven heavily by direct foreign investment in coastal projects. This period of robust growth transformed Costa Rica from a middle class market image to a more exclusive reputation with more expensive properties (e.g. Four Seasons), competing with their high end peers in Mexico and the Caribbean.

Regulatory and Administrative Aspects

In Costa Rica real estate projects must comply with current rules concerning forestry resources. The laws related to this issue are the Forestry Law, the Biodiversity Law, and the Wildlife Management Law. These laws and their corresponding regulations have produced numerous manuals and guides, which are the basis for management of the country's forestry resources.

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This article discusses experiences of developers, lawyers, and engineers in their dealings with governmental agencies when developing a real estate project in Costa Rica.

In recent years, the environmental aspect in real estate activities has acquired great social, media, and political relevance and scrutiny. This has inspired a series of modifications to the applicable Costa Rican laws and the establishment of environmental viability as a fundamental requirement to be approved by the competent governmental authorities as part of the development process. To this effect, in order to obtain the appropriate construction permits, it is essential to conduct a prior analysis of each project from an environmental perspective.

One of the most important requirements when developing real estate in Costa Rica is confirmation by the appropriate authorities that there is water available in a way and in sufficient quantity to adequately supply the project and its prospective users. This approval is typically expressed by the governmental authorities issuing a letter popularly referred to as a "Water Availability Letter." This letter is an essential requirement for the granting of environmental viability by Setena, the Costa Rican environmental agency. Without it, a developer will not advance far in the process of developing one's project and will not be able to obtain the needed construction permits.

Unfortunately, the process for obtaining the Water Availability Letter has become a cumbersome and very complicated process. It requires, depending on the case and the specific situation of a project, a well-prepared legal strategy and qualified technical advice.

The development of a property in Costa Rica involves a large quantity of authorizations and proceedings, both prior and during such development. These proceedings may be frustrating if the developer does not have the proper support and advice from his professional team. For

this reason, a multidisciplinary team, including attorneys, engineers and consultants, who would navigate and guide their clients through the large quantity of proceedings involved in the development of a property, is critical.

The process requires authorizations from at least the following governmental agencies: the local municipality; the Federate Professional Association of Engineers and Architects (Colegio Federado de Ingenieros y Arquitectos) (CFIA); the Costa Rican Institute of Sewerage and Water Supply Systems (AyA); the National Environmental Technical Secretariat (Setena); the Ministry of Health, and the National Institute of Housing and Urban Development (Invu).

Costa Rica is divided administratively into seven provinces. These are, in turn, divided into eighty-three cantons, each managed by a municipality or local government. In the last thirty years, the central government has tried to delegate more administrative and executive duties to the local municipalities, and each of them has sufficient authority to implement regulatory plans to regulate real estate development and construction in their jurisdictions.

In accordance with the above, construction projects must comply with the regulations established by the municipality in its regulatory plan, including meeting the applicable construction requirements. In particular, in order to confirm compliance, the local municipality must approve the construction plans for the real estate project.

The CFIA is the non-governmental administrative entity in charge of the oversight of good practice by architects and engineers. This body must approve the construction plans prepared by architects and engineers for a real estate project.

This is the first step and requirement in obtaining the construction plans for a real estate project. In order to initiate proceedings for approval of these plans, it is then necessary to pay in advance a series of tax stamps in favor of the CFIA.

The AyA is the centralized governmental agency responsible for managing sewage and water supply service in the country. It has had these responsibilities for the whole country for more than seventy years. However, the process of decentralization initiated by the Government to delegate more duties to local municipalities has also promoted private initiatives to provide water services.

Setena is the governmental entity in charge of overseeing compliance with the environmental legislation and the environmental requirements for development of real estate projects. Developers for all new construction projects which are subject to compliance with environmental requirements must file an application with Setena for review of their real estate project, seeking to obtain environmental viability.

Before a project is granted environmental viability by Setena, it will be subject to a series of studies including: forestry, hydrological, sociological, viability, impact, and pollution studies. These studies are a fundamental part of the real estate development process, not only because it is impossible to obtain construction permits without this approval, but also because these proceedings may take up to twelve months. This can have an important impact on the development agenda, the ability of the developer to obtain financing, and even its pre-sales ability.

The plans of a real estate project must be approved by the Ministry of Health, specifically by the leading health care unit in the place of development of the project. Through these proceedings, the Ministry of Health verifies that the structural plans of the project comply with the provisions established in the General Law of Health and in the Law of Equal Opportunities for Persons with Disability.

One of the most important requirements when developing real estate in Costa Rica is confirmation by the appropriate authorities that there is water available in a way and in sufficient quantity to adequately supply the project and its prospective users.

The proceedings before Invu are the final step prior to the submission of the construction plans of a real estate project to be built under the condominium property regime. Invu's duty is to see that the plans have the approvals described in the foregoing sections and that the construction plans meet the requirements established in the Construction Law, the Urban Development Law, and, when applicable, the Condominium Property Law.

The right to private property is recognized and protected by the Constitution of Costa Rica. Such provision indicates that no person can be deprived of one's private property unless it is for reasons of public interest. The Constitution also guarantees equal treatment to Costa Rican and foreign citizens with regard to private property and its disposal regime (Articles 19 and 23 of the Political Constitution of the Republic of Costa Rica). In this sense, any individual or legal entity that has acquired a property can freely dispose of it, without limitations other than those established by law.

These are various legal models by which a property can be developed in Costa Rica. In the past, the most commonly used model was the one established under the Urban Development Law. This permitted the partitioning of lots inside the same property, granting to these a new property numbers for their subsequent sale to third parties.

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Unlike the Urban Development Law, the Condominium Property Law (which replaced the previous Horizontal Property Law) permits the development of real estate projects horizontally and vertically, and not requiring the developer to donate a portion of its land to the local municipality.

The Urban Development Law, which remains in force, was very popular before the enactment of the Condominium Property Law. It permits the creation of the so-called urban developments, whereby a property was divided into new properties, which were in turn served by public streets and parks, on land donated by the developer to the local municipality. This required the municipalities to be responsible for the maintenance and care of the streets and parks created within said urban developments. As an essential requirement, the developer had to donate 10% of its land to be used as a public park inside the urban development.

With the enactment of the Condominium Property Law (and arguably even before with the amendment to the Horizontal Property Law), this model had lost its popularity. This was in particular due to the above mentioned requirements, which imposed on the developer an obligation to donate 10% of its land to the local municipality and convert the internal streets of the urban developments to public streets, generating concerns for the safety of the urban development residents.

The developments created were required to comply with the regulatory plans issued by the local municipalities and to have their plans approved by the National Institute of Housing and Urban Development (Invu) and the local municipality.

Under the Urban Development Law, the condominium plans must be duly approved by the local municipality, the AyA, the Ministry of Health, and Invu. Likewise, with respect to condominiums or real estate projects to be developed in a coastal zone, the condominium plans must be approved in preliminary form by the Costa Rican Tourism Institute ("ICT" by its Spanish abbreviation).

Once the plans have been approved by said entities, and following completion of the initial stage of the proceedings, the condominium plans are delivered to a Notary Public for preparation of the public instrument of organization of the condominium. Based on these plans, this instrument describes the future units to be built in the condominium. Following preparation of the public instrument of organization of the condominium, which must be signed by the owner of the property placed under the condominium property regime, a Notarial Certificate issued and filed with the Journal Section of the Real Estate Registry for registration, together with the condominium plans, shall be filed in the National Cadastral Registry. ❑

MEXICO

Proposed Amendments to IMMEX Program

By Marcos Guerra (Global-Trade Integral Solutions)

Since 2009, the Federal Government has been evaluating the possibility to implement several amendments to the Manufacturer, Maquiladora and Export Services Industry Decree (IMMEX Program). The main objective of such changes, were to put into practice some modifications to Maquiladora's regulations. However, such amendments were not published for several reasons, including a general rejection of some of the changes proposed.

However, Mexican Authorities are about to issue the revised amendments to the mentioned IMMEX Program Decree. This document could be officially issued through the Daily Official Gazette, during the next couple of months. Therefore, in order to provide an idea of the possible changes, below are the most important possible amendments. This article has been created based on a draft version; therefore, the objective is only to provide a preview of the Decree. Once the Authorities issue the official document, we will provide definitive comments on each modification.

Based on the draft of the IMMEX Program Decree, the most important proposed amendments are the following:

Derived from the merger of the former Program for the Temporary Importation of Goods to Produce Exportation Products (PITEX) and the Maquiladora Program into the IMMEX Program Decree, confusion was generated in the industry regarding the tax benefits for IMMEX Companies. The customs benefits for both Programs were almost the same; however from the tax perspective, there was several very important differences.

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As a result, Mexican Authorities are proposing a clearer definition of the "Maquiladora Operations", in accordance with the corresponding Transfer Pricing Rules established in articles 2 and 216-bis of the Income Tax Law. This amendment would also clarify when it is really possible to eliminate the Permanent Establishment Risk ("PE") for the foreign parent entity "Principal".

The proposal establishes that in order to consider an operation structure as a "Maquiladora", it is necessary to observe the following situations:

1. The raw materials, parts and components must be supplied by a third party (related or not, which usually is a foreign entity). The Mexican entity (herein after "IMMEX Company"), most have executed a toll manufacturing agreement with the third party (herein after "The Principal"). Such goods would be imported under the temporary customs regime in accordance with the IMMEX Program and the Customs Law, to be processed, transformed or repaired. The finished products should be returned abroad through direct or indirect exportation. Nineteen percent of the annual production could remain in Mexico; however, the customs regime must be changed from temporal to permanent importation and the corresponding import duties must be paid, there are also several variants to comply with the export obligation,
2. It is also possible for the IMMEX Company to perform domestic purchases of raw materials, parts and components to be used in the manufacturing process,
3. The fixed assets used to perform the corresponding processes must be owned (at least the 30 percent) by the "Principal", and should not be previously owned by the IMMEX Company. Therefore, the 70 percent of the fixed assets used to perform the Maquiladora activities, could be owned by the IMMEX Company or other non related Mexican party under a leasing agreement. The final Rules and Criteria in order to determine the ownership percentages of the fixed assets would be issued by the Customs Authorities IMMEX Companies that were operating before December 31, 2009 will not be subject of the mentioned ownership percentages regarding the fixed assets to the extent that all the tax obligations were fulfilled, including transfer pricing in accordance with article 216-bis of the Income Tax Law. However, from the permanent establishment perspective, Mexican Authorities might consider that at least part of such fixed assets and inventories must be imported under the temporary customs regime and be owned by the Principal.
4. It is worth mentioning that the domestic direct sales made by the IMMEX Company would not be considered as a Maquiladora operation. However, there are several Rules in order to allow the Principal to sell such goods in Mexico without returning them abroad.
5. In order to consider the activities as a Maquiladora operation, it is necessary to fully comply with articles 2 and 216-bis of the Income Tax Law.

The most important amendment within the proposal is the incorporation of the definition of the "Maquiladora Activities", providing more certainty to the industry.

Other important considerations derived from the proposal:

1. The authorized period of time to remain within Mexico for the temporary imported merchandises would remain the same:
   - Eighteen months for raw materials, parts and components,
   - Unlimited, to the extent that the IMMEX Program is in force, for fixed assets.
2. Sugar and raw materials, parts and components to be used in the metallurgy industry would be authorized for six months only,
3. For new authorization requests Mexican Authorities (Ministry of Economy) will require more detailed information regarding the operations to be held by the Mexican entity and would still require the opinion from the Ministry of Finance regarding the tax obligations of the interested company,
4. As part of the authorization process, the original visits from the Ministry of Economy to the facilities of the applicant will remain; however, such visits would be made in conjunction with the Ministry of Finance,
5. In addition, the Ministry of Economy would perform a physical evaluation of the temporary imported fixed assets, before granting the whole authorization to temporary import the inventories (raw materials, parts and components),
6. The proposal includes the possibility to cancel the IMMEX Program if one of the shareholders is related to a third company with a canceled IMMEX Program,
7. Once the cancellation process is started, the IMMEX Company would not be able to perform any operation under the Program,
8. Based on the proposal, it seems that the Annex IV of the IMMEX Decree (automated inventory control system), will be eliminated. However, the obligation will still be in force, since it is also establish within the Annex 24 of the World Trade General Rules, remaining as one of the most important obligations of

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such kind of entities. On the other hand, it would be impossible to comply with all the related obligations without the mentioned inventories control system,

9. The possibility to import goods within any customs office will remain,
10. The elimination of the obligation to request authorization to import goods under a special importers' registry, will also remain,
11. It is still not necessary to get authorization from the Authorities in order to temporarily import additional raw materials, parts and components under the IMMEX Program,
12. The ALTEX Program will be eliminated from the Decree; however, the benefits will remain for IMMEX Companies. In other words, in order to get the immediate VAT refund, it will be necessary to have an IMMEX Program,
13. The ECEX Program will be eliminated.

Conclusion

As a result of all the above mentioned, the most important amendment within the proposal is the incorporation of the definition of the "Maquiladora Activities", providing more certainty to the industry. It would be advisable to analyze current operation structures in order to be able to determine which tax and customs benefits are subject to be implemented depending on each operation. It is worth to mention, that the same entity would be able to have both operation structures (Maquiladora and regular manufacturing operation).

However, if that is the case, it will be necessary to apply the tax benefits for the Maquiladora, only for that portion of the whole operation.

In other words, it will be necessary to separately manage each business line implementing the tax and customs regulations and benefits depending on the corresponding business line.

It is possible that the new Decree enters into force in November 2010 but some of the modifications might enter into force, several months later, especially those related to Maquiladora. ❑

The New Mexican Federal Personal Data Protection Act

By Diego Martinez (Cervantes Sainz Abogados) and Jim Halpert (DLA Piper)

On July 6, 2010, Mexico became the latest world economy to adopt broad-based private sector data protection legislation with the Federal Act for the Protection of Personal Data Held by Entities and Individuals of the Privacy Sector (*Ley Federal de Protección de Datos Personales de los Particulares*) (the "Act").

The Act is the Mexican government's response to fulfill international standards regarding protection of personal data. Mexico joins Argentina and Uruguay as one of a few Latin American countries with broad data protection regulation. The Act is a major shift in privacy regulation in Mexico. Its requirements will not take effect until July of 2011, following the issuing of regulations which will clarify the scope of the Act's broad pronouncements. It is already clear, however, that the Act will demand several significant changes in business practices for commercial entities doing business in Mexico.

The Act largely tracks the OECD Guidelines, and is most similar to Canada's national privacy law, PIPEDA. In contrast to broad-based privacy laws enacted in Argentina and Uruguay, it does not follow the E.U. data protection regulation model. Instead, it adopts a middle ground position that is far more compatible with U.S. privacy law. The Act's principal requirements are to:

(1) provide detailed notice to data subjects;
(2) offer data subjects the right to opt-out of uses and disclosures of personal information and to an opt-in right for sensitive personal information;
(3) engage in fair processing of personal data;
(4) provide access, correction and rectification rights for data subjects to personal data about them;
(5) secure personal data;
(6) not keep personal data for longer than necessary; and

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(7) provide notification of security breaches involving personal data.

While the law contains significant potential sanctions, preliminary indications from the Federal Institute for Access to Information and Data Protection are that there will be a significant role for self-regulation and a significant emphasis on public education to adopt a culture of data protection in Mexico, rather than extensive enforcement for the next several years.

The Act implements the 2009 amendments to Articles 16 and 73 of the Political Constitution of the United Mexican States (*Constitución Política de los Estados Unidos Mexicanos*) (the "Constitution") that explicitly recognize the right to protection of Personal Data (as defined in the Act). Paragraph 2 of Article 16 now provides that "*Any person is entitled to the protection of his/her personal data, to the access, rectification, and cancelation of same...in accordance with the provisions set forth in the Law, which shall provide for exceptions and the principles ruling the treatment of data…*". Article 73 of the Constitution was amended to provide that the Congress may issue any kind of legislation in connection with the protection of Personal Data.

Salient Features

Scope: As drafted, the Act appears to apply to all data that is processed in Mexico without regard to the nationality of data subjects in question. It also appears to apply to websites that target Mexican Internet users. Furthermore, personal data is defined quite broadly as any information regarding an identified or identifiable individual.

On the other hand, the Act provides for uniform federal regulation so as to prevent a multiplicity of local laws governing Personal Data. It applies to private parties, both individuals and entities, in possession of or managing Personal Data[1] (referred to as "Responsible Parties") other than: (i) credit reporting corporations (*Sociedades de Información Crediticia*), who are regulated separately; and (ii) entities that maintain and/or manage Personal Data for their own use and not for commercial purposes or for purposes of disclosing the information.

Most of the Act's requirements are aimed at the processing ("*Tratamiento*") of personal data. "*Tratamiento*" is defined as "the procurement, use, disclosure, or storage of personal data by any means". Art. 3, XVIII. "*Use*" is in turn defined broadly to cover "*any act of access, management, exploitation, transfer or disposition of person data.*" *Id.* This combination of definitions approximates the broad definition of processing under the E.U. Data Protection Directive.

The Act's requirements are imposed on "*those responsible for*" processing personal data ("responsible parties"), who are defined as private individuals or entities "deciding over the *Tratamiento* of personal data." (Art. 3, XIV) This definition closely resembles the definition of a data controller under the E.U. Data Protection Directive.

Notice and Consent: The Act adopts a notice and opt-out/opt-in consent regime for processing ("*Tratamiento*") of Personal Data.

Responsible parties must notify the data subjects in a privacy notice of the personal data of the data subject that is in the possession of and under the management of the Responsible Party and the purposes for which it was obtained. The Privacy Notice must describe (1) the identity and address of the responsible party; (2) the purposes of the processing; (3) the choices and means available to the data subject to limit the use and disclosure of the personal data; (4) how to exercise access and correction rights; (5) data transfers that have been effected; and (6) how the responsible party will notify the data subject of changes to its privacy notice. The Act provides for *opt-out* consent for all processing covered by the privacy notice except in the case of sensitive data and financial data, for which *opt-in* consent is required. Consent may be revoked at any time per the method(s) set forth in the privacy notice. Processing that is beyond the scope of disclosures in the privacy notice and is not compatible or analogous to them requires a separate, new consent.

The Act largely tracks the OECD Guidelines, and is most similar to Canada's national privacy law, PIPEDA.

Exceptions to opt-out and opt-in consent apply in the case of: (1) data contained in publicly available databases; (2) data that has been de-identified; (3) processing for the purposes of performing obligations derived from a legal relationship with the data subject; (4) an emergency threat to an individual or his or her assets; (5) medical necessity; or (6) authorization by statute or a competent legal authority.

Data Security: Responsible Parties must establish and maintain administrative, technical and physical security measures necessary to protect the Personal Data from damage, loss, alteration, destruction, and from any resulting unauthorized use, access or processing. These should take account of existing risks, possible consequences for data subjects, the sensitivity of the data, and technology developments. The security measures may not be of less quality as those applied to protect the responsible party's own information. Responsible parties and third parties who participate in processing of personal data are required to maintain its confidentiality both during and after the responsible party's relationship with the data subject.

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Data Protection Act (from page 29)

Access and Correction Rights/DROs: The Act provides that any data subject shall have the rights of access, rectification, cancelation or opposition for his or her personal data. The Act sets out detailed procedural requirements relating to the exercise of these rights. Data subjects also have a right to obtain the responsible party's privacy notice. These rights may be exercised starting 18 months after the Act's effective date – January, 2012.

By July, 2011, all responsible parties must appoint a private data responsible officer ("DRO"), who is responsible for answering data subject's requests. The DRO is also responsible for the protection of personal data within all the employees of the Responsible Party.

Data Transfer: International data transfers of personal data are permitted if three conditions are met. First, the responsible party must inform the data subjects through the Privacy Notice that the personal data may be transferred and the purpose for the transfer. Second, the responsible party must bind the recipient of the transferred personal data in a data transfer agreement to comply with all of the responsible party's obligations under the Act. Third, the responsible party must inform the foreign data recipient of the privacy notice and the purposes for which the data subject authorized processing of the personal information.

There are some circumstances provided for in the Act where the Personal Data may be transferred, without these requirements. These include transfers: (i) authorized under international treaties to which Mexico is party, (ii) between affiliates; (iii) necessary to protect the "public interest"; (iv) necessary to protect a right to be exercised in court (which appears to permit transfers for Discovery purposes); (v) necessary for medical purposes; and (vi) necessary by virtue of an agreement executed by the responsible party "in the interest of the data subject".

Security Breach Notification: Responsible parties are required immediately to notify the data subject of any breach of security occurring at any stage of processing that "*significantly affects the economic or moral rights of the data subject*." This requirement, like many others in the Act, is stated very briefly and will be fleshed out in regulations.

Data Deletion/Fair Processing: When personal data is no longer necessary for the purposes set forth in the privacy policy or applicable law, it should be deleted. For sensitive personal information, responsible parties are required to make reasonable efforts to process the information for the shortest period possible. Information on bankruptcies and other failures to live up to contractual obligations must be deleted from databases within six years of the default.

More generally, personal data maintained in databases are to be relevant, accurate and up-to-date, and personal data may not be obtained through deceitful or fraudulent means.

Furthermore, responsible parties are required to take necessary actions to ensure that vendors and other third parties who touch personal data abide by all the terms of the privacy notice.

Enforcement and Education: The Federal Institute for the Access of Information and Protection of Personal Data (*Instituto de Acceso a la Información y Protección de Datos Personales*) (the "Institute") is charged with diffusing the right to the protection of Personal Data in Mexican society, promoting observance of these data protection rights, and conduct oversight of the observance of the Act's requirements.

The Act provides for uniform federal regulation so as to prevent a multiplicity of local laws governing Personal Data.

The Institute has the following powers: (i) supervising and verifying compliance with the provisions of the Act; (ii) interpreting the Act for administrative purposes; (iii) providing technical support to Responsible Parties for their compliance of their obligations; (iv) issuing guidelines and recommendations as required by the due application of the Act; (v) disclosing standards and international practices regarding the security information, in relation to the nature of the data; the purposes for which it is processed, and the technical and economic capacities of the responsible party; and (vi) investigating and potential violations and imposing sanctions.

The Institute may: (i) grant a stay or discard the data protection request, or (ii) confirm, revoke or modify the response of the Responsible Party.

Both monetary and criminal penalties may be imposed for violations. The Institute is entitled to impose financial penalties. Imprisonment for felonies as a consequence of violation of provisions of the law is possible under criminal law derived from claims filed by the public prosecutor (*Ministerio Público*) per request either of the Relevant Protected Person or the Institute. Criminal penalties are imposed when Personal Data is unduly used and as a result security of the Relevant Protected Person is or could be triggered.

Penalties and sanctions for violations of the Act include among others, fines for amounts ranging between approximately $500 and $1.5 million. In case of repetitive violation, fines may be imposed for an amount equal to 2 times the applicable fine. Moreover, criminal penalties of 3 months to 10 years of imprisonment may be imposed.

Additionally, the Ministry of Economy (*Secretaría de Economía*) (the "Ministry") is charged with spreading

awareness of the obligations regarding protection of Personal Data between the private national and international sectors with commercial activity in Mexican territory. The Ministry is to promote commercial best practices relating to protection of personal data for the development of the digital economy and of the national economy. The Ministry is given authority to: (i) spread knowledge in respect of the protection of Personal Data in the field of commerce; (ii) foster healthy commercial practices regarding the protection of personal data; (iii) with the cooperation of the Institute, issue the corresponding regulations relating to content and scope of the privacy notices referred to in the Act; and (iv) carry out the registries of consumers in respect of personal data and verify their functionality. ❑

1 Personal information in possession of governmental entities is already protected by the Federal Act on Transparency and Access to Government Public Information enacted in 2007.

Class Action Lawsuits in Mexico

By Cacheaux, Cavazos & Newton, L.L.P.

The Official Journal of the Federation published on July 29, 2010 an amendment to article 17 of the Constitution of the United Mexican States to create in Mexico the legal concept of class action lawsuits, i.e. lawsuits brought by a group of people that meet a uniform set of conditions arising from the same cause that resulted in losses or claims. The constitutional reform limits class action lawsuits to proceedings regarding federal law, such as those relating to consumers, users of financial services and matters concerning the environment, and grants federal judges exclusive jurisdiction to hear such cases. It is also important to note that Mexico's Congress will have one year to issue secondary legislation on how to regulate class action lawsuits.

Rules on class actions are nothing new, since countries like the United States, Spain, Colombia, Brazil, Argentina and Chile, among others, already have rules on this type of collective actions at a constitutional and secondary level of legislation. With the constitutional amendment to Article 17, the scope of a ruling on class actions lawsuits would be valid for a group of people who are in an identical situation to that of any plaintiff who has filed a lawsuit against an institution or entity. Additionally, this amendment will compensate victims that sustain damages resulting from monopolies, unfair claims, abuse and fraud and other causes of action that give rise to a class action lawsuit.

It is estimated that the success of this legal concept will depend largely on secondary legislation approved by Mexico's Congress. Up until this constitutional reform, the only class action available at the federal level could be filed only by the Federal Office of Consumer Protection ("Procuraduria Federal de Proteccion al Consumidor" or "PROFECO") against companies that defrauded customers, but its effectiveness and scope was limited and was subject to the willingness of the authority to prosecute any given case. Last May, Mexico's Supreme Court ruled for the first time on class action lawsuits brought by PROFECO, and held that the benefits of a judgment from such lawsuits must accrue to all affected consumers, not just those who joined in the lawsuit. ❑

The constitutional reform limits class action lawsuits to proceedings regarding federal law, such as those relating to consumers, users of financial services and matters concerning the environment, and grants federal judges exclusive jurisdiction to hear such cases. It is also important to note that Mexico's Congress will have one year to issue secondary legislation on how to regulate class action lawsuits.

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Mexican Intellectual Property Information: *Opposition to the Grant of Patents?*

By Cacheaux, Cavazos & Newton, L.L.P.

According with the provisions of Mexico's Industrial Property Law (LPI), inventions are patentable if: 1) they are the result of a creative activity; 2) have an industrial application; 3) and, are new. Five exceptions to such provision are set forth in Article 16 of the LPI. Additionally, Article 19 of the LPI provides cases for which inventions cannot be considered for registration. Similarly, legislation in this area provides that once a patent application is filed with the Mexican Institute of Industrial Property (*Instituto Mexicano de la Propiedad Industrial* or "IMPI") an administrative review must be carried out. Such administrative review basically consists of a formal examination of the filed application documents, which is followed by the publication of the patent application in the Official Gazette of the IMPI, usually within 18 months from the filing date (such publication can occur before such 18-month period upon request to the IMPI).

This has been the normal patent registration process for a long time. As of last June, however, a decree was published in which several articles were added to the LPI. The highlight of such decree, among others, is the new Article 52a, which states that within six months, counted from the date of publication of any patent application published in the Official Gazette, the IMPI may receive public comment concerning the application's compliance with the provisions set forth in Articles 16 and 19 of the LPI (conditions for obtaining a patent on inventions that are considered patentable). Comments that the IMPI receives pursuant to Article 52a do not mandate the IMPI to rule in a certain way. Nevertheless, this is the first time that Mexico considers the possibility of allowing an interested third party to submit some sort of "opposition" to the granting of a patent.

This may be an important step (and with time these "oppositions" may occur more often) that could spread to other areas of industrial property, including trademark registrations, as in many other countries. ❏

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