NYSE

NYSE: Corporate Governance Guide

Mexico

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Mexico's legal framework underwent a substantial revision in the last couple of years. Amendments to the Mexican Constitution and several laws and regulations were passed in connection with fundamental areas such as education, labor, and tax, as well as in sectors critical to the Mexican economy, including banking, telecommunications, and energy. Although the benefits of these reforms in Mexico's business and corporate environments are not expected to materialize in the short term, a few examples of their impact to corporate governance are already in place and may give a hint of what is to come in the future.

Mexican stock corporations: overcoming paternalism

On June 13, 2014, amendments to the General Law on Commercial Companies (*Ley General de Sociedades Mercantiles*, or LGSM) were enacted, which, despite not being revolutionary or innovative per se, are significant due to the role such amendments play in the policy underlying commercial legislation in general and more concretely in the structuring of adequate governance provisions.

In the 80th year since its enactment, the LGSM is often criticized for being overly protective of minorities and unreasonably intruding into business aspects pertaining to Mexican stock corporations (*sociedad anónima*, or SA), but most of all, for perpetuating an outdated regulation of commercial entities that is inconsistent with the developments achieved in the business world during the last decades. It was not until the enactment in 2006 of the Law on the Securities Market (*Ley del Mercado de Valores*, or LMV) that "investment promoting stock corporations" (*sociedad anónima promotora de inversión*, or SAPI) were introduced as a modality of the traditional SA, aimed to foster the private equity market with a corporate vehicle that was not only less restrictive than the SAs but also more compatible with structures used by investors in other jurisdictions.

The latest amendments to the LGSM substantially replicate the legal framework applicable to SAPIs and make it available to SAs, which effort may be construed as one of the first steps taken by Mexican legislators in a long path leading to a legal

framework similar to those applicable in jurisdictions where the parties to contracts (and ultimately the market) determine the terms of commercial relationships. Among other matters, SAs now enable investors to: (1) freely determine the voting and economic rights of shares; (2) freely restrict the transfer of shares; and (3) enter into shareholders' agreements and implement deadlock, drag-along, tag-along, registration, and similar rights. Furthermore, these amendments also lower the minority thresholds required to: (1) initiate civil actions against directors; (2) postpone the voting of matters on which shareholders consider themselves not fully informed; and (3) oppose shareholders' resolutions. Additionally, the LGSM now requires directors to maintain confidentiality on all nonpublic matters and information obtained during their tenure and for one additional year thereafter.

Mexican REITs: raising an industry standard

The amendments to the regulations applicable to securities issuers (*Disposiciones de carácter general aplicables a las emisoras de valores y a otros participantes del mercado de valores*, or Issuers Regulations) enacted on June 17, 2014, represent a limited but welcome effort to raise the corporate governance standards applicable to Mexican real estate investment trusts (*fideicomisos de inversión en bienes raíces*, or Fibras). Said amendments introduce minority rights applicable to Fibras, forbid related parties or parties that have a conflict of interests from voting in certain matters, and establish certain restrictions in connection with the leverage and debt service coverage ratios of Fibras.

Among others, the amendments to the Issuers Regulations set forth that the vote of the general meeting of the holders of the certificates issued by a Fibra (*certificados bursátiles fiduciarios inmobiliarios*, or CBFIs) is required in order to approve: (1) related party transactions or those that may otherwise imply a conflict of interests, in case the relevant transaction represents 10 percent or more of the relevant Fibra's trust estate; (2) any amendments to the compensation paid to the manager of the Fibra or to the members of its technical committee (the manager and parties related to the settlor, the manager, the trust's subsidiaries, and any holders of CBFIs that have a conflict of interests are expressly forbidden from casting their vote in connection with these matters and those specified in the previous item); (3) the removal of the manager of the trust; (4) the issuance of new CBFIs; and (5) policies pursuant to which the Fibra may enter into or assume indebtedness and any amendments thereto (also subject to certain statutory restrictions further discussed below).

Additionally, the amendments to the Issuers Regulations provide that the technical committee of Fibras must approve: (1) any transaction representing five percent or more of the relevant Fibra's trust estate; (2) operating policies in connection with parties related to the settlor, the manager of the trust, and the trust's subsidiaries; and (3) individual related party transactions or transactions that imply a conflict of interests (which must be entered into on an arm's-length basis and require the affirmative vote of the majority of the independent members of the technical committee).

As to financial responsibility, the amendments to the Issuers Regulations (1) forbid Fibras from incurring in liabilities in excess of 50 percent of the book value of the relevant Fibra's assets and impose the obligation to maintain at least a 1.0 debt service coverage ratio (during the following six quarters), and (2) require Fibras to have a committee composed in its majority by independent members of the technical committee in order to oversee that mechanisms and controls are established to verify that the indebtedness incurred or assumed by the relevant Fibra conforms to applicable law.

Directors, officers, and bankruptcy: Vitro's Wake

Important amendments to the Mexican Bankruptcy Law (*Ley de Concursos Mercantiles*, or LCM) were enacted on

January 10, 2014. Besides introducing several substantive and procedural innovations for the benefit of creditors (eg subordination and a longer look-back period applicable to intercompany and related party liabilities, stricter requirements to cram down legitimate third-party liabilities, consolidated insolvency procedures for corporate groups, clear-cut rules for debtor-in-possession financing, strict limitations to the length of the conciliatory stage of the procedure), said amendments introduced important fiduciary duties and penalties applicable to directors and officers of insolvent entities.

Pursuant to the amendments to the LCM, directors and officers may be liable for damages and lost profits caused to an entity in case the latter is insolvent and when any of the following hypotheses is verified by their conduct: (1) adopting decisions involving the entity's property, despite having a conflict of interest; (2) knowingly favoring a shareholder or group of shareholders in prejudice of the rest of the shareholders; (3) in absence of a legitimate cause and by virtue of their position, obtaining economic benefits for themselves or on behalf of third parties, including any shareholder or group of shareholders; (4) preparing or disclosing information having knowledge of its falseness; (5) causing the omission from registration of transactions performed by the entity, or altering or ordering the alteration of records with the purpose of concealing the true nature of the transactions performed, affecting the entity's financial statements; (6) ordering or accepting the recording of false data in the accounting records of the entity; (7) destroying or amending systems, accounting records, or supporting documents of accounting records of the entity with the purpose to conceal the relevant records or evidence; (8) altering accounts or the terms of agreements, recording inexistent transactions or expenses, exaggerating the real ones, or willfully carrying out any illegal action or transaction, if an indebtedness, loss, or damage to the entity's property is caused and an economic benefit is obtained for themselves or third parties (including related parties); and (9) in general, acting willfully or in bad faith, or carrying out illegal actions.

Additionally, the amendments to the LCM introduce a penalty of imprisonment for 3 to 12 years that may be imposed on members of the board of directors, sole administrator, CEO, and officers of an entity that has been declared insolvent, if (1) through the altering of accounts or the terms of agreements they knowingly cause the registration of inexistent transactions or expenses, or (2) they willfully carry out any illegal action or transaction, if a damage to the entity's property is caused and an economic benefit is obtained for themselves or third parties (including related parties).

Moreover, mimicking the "business judgment rule" applicable in other jurisdictions, the amendments to the LCM exclude directors' and officers' liabilities, when acting in good faith, they (1) comply with the requirements set forth in applicable law or the entity's by-laws for the approval of matters on which the board of directors is competent to decide; (2) adopt decisions based on information provided by officers, external auditors, or independent experts, when their capacity and credibility "offer no motive for reasonable doubt"; (3) select the most adequate alternative to the best of their knowledge, or the possible damage to the entity could not have been foreseen, in either case, based on the information available at the time they made their decision; and (4) comply with the resolutions adopted by the shareholders, provided said resolutions are not illegal.

Entities are forbidden from including in their by-laws any benefits, considerations, or liability waivers that limit, release, substitute, or offset the aforementioned liabilities of directors and officers; however, they may retain insurance policies or guaranties covering damages and lost profits, except in case of actions carried out willfully or in bad faith or that are otherwise illegal.

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- Navigating the changing landscape of corporate governance
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- Implementing risk-management controls
- Overseeing a succession plan for senior management
- Communicating effectively with shareholders
- Assembling a comprehensive ethics and compliance program

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