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Entering the Construction Services Industry in Mexico: Laws Affecting Foreign Participation, NAFTA, and Other Concerns

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I. INTRODUCTION

With the current growth in the Mexican economy and population,[1] there is a tremendous need for the construction of housing and infrastructure in Mexico.[2]

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1. *See infra* notes 63-65 and accompanying text.
2. *See infra* notes 61-73 and accompanying text.

The lagging construction industry in the United States,[3] coupled with increasingly favorable business conditions in Mexico, is causing U.S. construction firms to look south of the border for business. While U.S. contractors can expect to find ample business opportunities in Mexico,[4] they should also expect to find a variety of laws that will impact on the planning and operation of their foreign construction undertakings.[5] After briefly detailing Mexico's economic recovery, this comment provides practitioners and business owners with a sampling of some of the relevant factors that must be considered before entering the construction services industry in Mexico. Part II assesses Mexico's recent economic recovery and its future outlook.[6] Part III identifies the current and projected demand for construction services in Mexico.[7] Part IV discusses pertinent rules and regulations affecting the practice of construction in Mexico.[8] Part V focuses on an important nonlegal consideration: The availability of financing for Mexican projects.[9] Finally, part VI discusses how construction opportunities for U.S. firms in Mexico will be affected by the North American Free Trade Agreement (NAFTA).[10]

II. THE MEXICAN ECONOMY

Prior to the debt crisis[11] that struck Mexico in 1982, the Mexican economy was relatively prosperous and stable.[12] The construction industry, leading all sectors in growth for 1980 and 1981, saw a hefty forty-five percent increase in production over that two-year period.[13] The 1982 debt crisis, however, severely

3. *Bay Area Firms Heading for Mexico: Top Companies Lead Rush*, SAN FRANCISCO BUS. TIMES, Oct. 9, 1992, § 1, at 1.
4. *See infra* notes 61-73 and accompanying text.
5. *See infra* notes 74-252 and accompanying text.
6. *See infra* notes 11-60 and accompanying text.
7. *See infra* notes 61-73 and accompanying text.
8. *See infra* notes 74-252 and accompanying text.
9. *See infra* notes 253-65 and accompanying text.
10. North American Free Trade Agreement [hereinafter NAFTA]. All references to NAFTA are to the December 17, 1992 draft. *See infra* notes 266-92 and accompanying text.
11. "Debt crisis" is a term that refers to Mexico's inability to effectively service the large debt that it owed to international sources. *See generally* NORA LUSTIG, MEXICO: THE REMAKING OF AN ECONOMY 20-21 (1992). When oil prices rose sharply in 1980, Mexican policy makers mistakenly believed that the upward trend would be permanent, and this belief prompted Mexico to engage in an "investment spree." *Id.* at 20-21. Although resulting in impressive domestic output and employment, the large public expenditures fostered a rising fiscal deficit. *Id.* To finance the deficit, Mexico borrowed heavily from foreign sources, especially from commercial banks. *Id.* at 21. When oil prices dropped and interest rates rose in 1981, contrary to expectations, Mexico found itself spending more and more of its foreign earnings to service the debt it had amassed and the deficit reached unprecedented heights. *Id.* at 24. In early 1982, oil prices continued to slide, the peso was devalued, and foreign investors pulled their capital out of Mexico. *Id.* In August 1982, the cessation of commercial lending to Mexico led to further and more severe devaluations in the currency, and Mexico announced a 90-day suspension on foreign debt payments of the principal. *Id.* at 25.
12. INVESTING IN MEXICO 7 (The Conference Board, Inc. ed., 1992) (editor's comments).
13. William Neuman, *Building Its Way Back*, BUS. MEX., June 1990, *available in* LEXIS, News Library, Busmex File.

crippled Mexico's economic growth,[14] leaving the country in a state of "total macroeconomic disequilibrium—a vicious circle of debt, inflation, and stagnation."[15] The construction industry, whose performance is related not only to the economy but to the Mexican government's investment policy,[16] suffered a substantial decline in revenues when public investment fell from 12.5 percent of gross domestic product (GDP) in 1981 to 3 percent in 1988.[17] For the 10,000 member construction companies comprising the National Chamber of the Construction Industry, production declined by fifty-two percent between 1981 and 1988.[18]

The election of Harvard-educated President Carlos Salinas de Gortari in 1988[19] marked the beginning of a new era for Mexico, one in which unprecedented policies were implemented to inject life into a badly wounded economy. Although an in-depth consideration of the policies fueling the revitalization of the Mexican economy is outside the scope of this comment, a brief look at the strategies undertaken by President Salinas will help to understand how confidence has been restored in Mexico in such a short time. President Salinas has vigorously pursued structural changes to stabilize the Mexican economy and pave the way for economic growth.[20] Balancing the federal budget through a combination of fiscal and monetary policies has been critical to Mexico's economic recovery.[21] In the early 1980s, Mexico's budget deficit was approximately eight percent of Mexico's GDP.[22] However, the implementation of new fiscal and monetary policies led to a surplus of seven percent of GDP by the early 1990s.[23]

The policies responsible for this substantial improvement in the budget are external debt renegotiation,[24] privatization of enterprises,[25] tax reform,[26] and public expenditure changes.[27] The renegotiation of external debt[28] has contrib-

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14. INVESTING IN MEXICO, *supra* note 12, at 7.
15. Ernesto Zedillo, *Mexico's Economic and Investment Climate, in* INVESTING IN MEXICO, *supra* note 12, at 9, 9.
16. Since most funding for infrastructure construction is public, the government's investment policy impacts on the construction industry. *Id.*
17. Xavier Gutierrez, *Mexico: New Policies Create Opportunities,* INSTITUTIONAL INVESTOR, Dec. 1993, at S2. Gross domestic product is defined as "[a] measure of the total flow of goods and services produced by the economy over a specified time period, normally a year." AULD ET AL., THE AMERICAN DICTIONARY OF ECONOMICS 131 (1983).
18. Neuman, *supra* note 13.
19. Mary B. Powers, *Firms Eye Piñata of Projects,* ENGINEERING NEWS-REC., Oct. 14, 1991, at 38.
20. *See* INVESTING IN MEXICO, *supra* note 12, at 7.
21. *See* Zedillo, *supra* note 15, at 9-10 (discussing fiscal and monetary policies).
22. Guillermo Ortiz, *Mexico's Financial Outlook, in* INVESTING IN MEXICO, *supra* note 12, at 11, 11.
23. *Id.*
24. *See infra* notes 28-34 and accompanying text.
25. *See infra* notes 35-39 and accompanying text.
26. *See infra* notes 45-48 and accompanying text.
27. *See infra* notes 50-55 and accompanying text.

uted to the stabilization of the economy by enabling Mexico to realize a reduction in interest payments.[29] Whereas gross external debt represented seventy percent of GDP from 1986 to 1989, it fell to only thirty-five percent by 1991.[30] To comprehend how reducing its external debt balance has benefited Mexico, consider Mexico's renegotiation of its medium-term debt. By reaching a debt accord with U.S. commercial banks under the Brady Plan,[31] Mexico reduced its $48 billion of medium-term debt by $7 billion.[32] This debt reduction saves the country $1.6 billion in interest annually.[33] This reduction in interest payments helped reduce the net transfer of Mexico's resources abroad, thus increasing the availability of pesos for investment at home in Mexico.[34]

In addition to debt renegotiation, the privatization[35] of over 1000 state enterprises, including banks, telephone companies, and airlines,[36] has improved Mexico's budgetary situation by generating large one-time revenues and eliminating many government subsidies.[37] For example, in 1992, Mexico sold eighteen commercial banks, for which the Mexican government received $12.4 billion, and *Teléfones de Mexico* (Telmex), which raised $1.4 billion.[38] This privatization scheme reduced the number of government-owned enterprises from 1200 in 1982 to an estimated 234 in 1992.[39]

Mexico's budgetary situation has also been improved by tax reforms that have increased tax revenues.[40] One of the Salinas administration's goals has been to

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28. External debt is debt that is owed to foreign sources. *See* LUSTIG, *supra* note 11, at 21. In an effort to reduce external debt, Mexico persuaded the U.S. government to pressure U.S. commercial banks into renegotiating the debt owed them by Mexico. *Id.* at 56. Consequently, the U.S. government launched the Brady Plan, a strategy to reduce Mexico's debt and debt service. *Id.* Pursuant to the Brady Plan, Mexico signed an agreement with U.S. commercial banks in 1989 to renegotiate $48 billion worth of debt. *Id.* at 141.

> The agreement presented the banks with three options: (1) exchange debt at a 35 percent discount for a single maturity, thirty-year bond [with a variable rate], (2) exchange debt for a thirty-year par bond carrying a fixed 6.25 percent interest rate, or (3) provide new lending over the next four years equivalent to 25 percent of the bank's outstanding debt not assigned to option 1 or 2.

Id.

29. Ortiz, *supra* note 22, at 11.
30. *Id.*
31. *See supra* note 28 (discussing the Brady Plan).
32. Upendra N. Mishra, UPI, Dec. 24, 1990, *available in* LEXIS, News Library, Curnws File.
33. *Id.*
34. Zedillo, *supra* note 15, at 10.
35. Privatization occurs when the government sells nonstrategic public enterprises to private concerns. *Id.* at 9.
36. Ortiz, *supra* note 22, at 12.
37. Zedillo, *supra* note 15, at 9. Privatization actually started during the administration of President de la Madrid but gained momentum under President Salinas. LUSTIG, *supra* note 11, at 104.
38. Mari C. Campos, *Mexico: Land of Opportunity?*, 3 Mex. Trade & L. Rep. (Int'l Trade Info. Corp.) No. 7 (July 1993).
39. *Id.*
40. LUSTIG, *supra* note 11, at 99.

lower tax rates and at the same time expand the tax base.[41] Tax reforms in 1986 and 1988,[42] coupled with a major tax reform introduced by President Salinas in 1989, produced tax rates more favorable to businesses and individuals.[43] The corporate tax rate was reduced from forty-two to thirty-five percent, and the maximum individual income tax rate was reduced from fifty-five to thirty-five percent.[44]

Even though tax rates were reduced, Mexico's increased attention to enforcing tax compliance raised tax revenues by forty percent between 1989 and 1991.[45] Before President Salinas took office in 1988, the government had prosecuted only two cases of tax evasion.[46] However, "[a] rash of audits, prosecutions[,] and subsequent jailings for tax evasion and fraud during the first two years of [Salinas'] term have [*sic*] significantly increased tax compliance."[47] The success of this stepped-up enforcement was manifested in an amazing sixty-four percent increase in the number of taxpayers from 1988 to 1990.[48]

The large fiscal deficit that contributed to the 1982 debt crisis in Mexico was due in part to large public expenditures made by the government under the mistaken belief that oil prices would continue to climb upward.[49] To get the deficit under control, Mexico severely curbed public expenditures.[50] Public investment was slashed from 12.5 percent of GDP in 1981 to only 3 percent in 1988.[51] Having improved its budget deficit, Mexico has taken a new approach to public spending.[52] Public investment is now restricted to available resources.[53] In addition, Mexico made cuts in nonpriority areas to free resources for important areas like basic infrastructure, education, and the environment.[54] Furthermore, Mexico continues to work toward attracting greater private investment in areas such as infrastructure, where previously funding was primarily

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41. GRAY NEWMAN & ANNA SZTERENFELD, BUSINESS INTERNATIONAL'S GUIDE TO DOING BUSINESS IN MEXICO 119 (1993).

42. LUSTIG, *supra* note 11, at 99. Tax reform in 1986 included changing indexation mechanisms for interest payments, depreciation, and inventories, which stimulated investment and favored equity financing as opposed to debt financing. *Id.* It also brought corporate tax rates closer in line with international standards and reduced income losses resulting from collection lags. *Id.* Reforms in 1988 lowered the maximum personal income tax and imposed a 2% tax on business assets. *Id.*

43. NEWMAN & SZTERENFELD, *supra* note 41, at 119.

44. Gustavo Prado, *Tax Laws and Regulations Affecting Private Investment*, *in* INVESTING IN MEXICO, *supra* note 12, at 19, 19.

45. Ortiz, *supra* note 22, at 11.

46. NEWMAN & SZTERENFELD, *supra* note 41, at 120.

47. *Id.* Audits increased from 1.2% of all taxpayers in 1988 to about 10% of all taxpayers in 1990. *Id.*

48. *Id.*

49. LUSTIG, *supra* note 11, at 21. *See also supra* note 11 (discussing the 1982 debt crisis).

50. LUSTIG, *supra* note 11, at 99.

51. Gutierrez, *supra* note 17, at S2.

52. Zedillo, *supra* note 15, at 9.

53. *Id.*

54. *Id.* In 1992, spending on education alone was expected to be increased by 26%. *Id.* Spending on the environment was expected to increase by 30%. *Id.*

from public sources.[55] Through a combination of these policies of debt renegotiation, privatization, tax reform, and public expenditure changes, Mexico has significantly improved its fiscal situation, and consequently, Mexico is now "held up by the World Bank as a sparkling example of how Third World countries can improve their economies."[56]

As for the future of the Mexican economy, it is estimated that Mexico is capable of sustaining growth in its GDP of five percent annually between 1995 and 2000.[57] With the continued balanced budget, inflation should stabilize at between five and seven percent.[58] The construction sector, which grew at a rate of three times that of GDP in 1992, is expected to continue to outperform the economy over the next several years, especially in light of the Mexican government's commitment to infrastructure and housing investment.[59] According to one estimate, the housing, construction, and related services markets should experience an average annual growth of twelve percent over the next few years.[60]

III. DEMAND FOR CONSTRUCTION SERVICES

In the words of a prominent California-based developer, Don Koll, who has already invested millions of dollars in Mexico, "Nothing in Mexico is overbuilt, Mexico needs everything."[61] While this assessment of the demand for construction services in Mexico may sound overly optimistic, this comment supports Koll's assertion by quantifying the demand for residential, commercial, industrial, and infrastructure projects. Based on the current and projected deficit of housing in Mexico, demand for the construction of dwelling units should remain strong for several years. The Mexican government published the National Housing Plan in 1990 that estimated the housing deficit at 6.1 million units, and the demand for housing is expected to intensify.[62] The expansion of Mexico's economy is

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55. *Id.*

56. Julian D. Nihill, *No More Mañana*, RECORDER, July 22, 1993, at 8.

57. Carlos Fritsch & Herbert Hart, *Mexico: Outlook Remains Bright*, INSTITUTIONAL INVESTOR, Dec. 1993, at S5.

58. *Id.* Inflation dropped from 132% per year in 1987 to 14% in 1992. Christopher J. Graddock, *The North American Free Trade Agreement: Economic Integration and Employment Dislocation*, 19 J. LEGIS. 265 (1993).

59. *Id. See infra* notes 72-73 and accompanying text (discussing Mexico's plans for investment).

60. *U.S. Construction and Engineering Firms Will Benefit*, 3 Mex. Trade & L. Rep. (Int'l Trade Info. Corp.) No. 6 (June 1993).

61. Kelly, *Koll Co. Sets Sights on Baja Beaches, Mexican Interior*, SAN DIEGO BUS. J., Sept. 21, 1992, § 1, at 1.

62. U.S. Dep't of Commerce, *The Construction Market in Mexico*, CONSTRUCTION REV., July/Aug. 1991, at ix. "The greatest housing deficit is in the outskirts of urban cities, such as Mexico City (2.7 million homes), Guadalajara (0.5 million), Monterrey (0.5 million), and those in the northern states (1.2 million). The estimated housing deficit in rural areas is 1.2 million units." *Id.*

increasing the working population at a rate of 1.4 million individuals per year.[63] Each year Mexico's population growth raises the demand for housing by an estimated 250,000 units.[64] Furthermore, since sixty percent of Mexicans are now under twenty-five years of age, the number of Mexicans seeking housing will greatly escalate in coming years.[65] According to an official in Mexico's Ministry of Social Development, "'The size of the [housing shortage] problem is huge, and it is increasing.' ... 'This is an open area where we could attract foreign investment.'"[66]

Demand for the construction of commercial and industrial projects is also strong and expected to intensify in the coming years. According to Cushman and Wakefield, Inc., a large New York City real estate brokerage firm that recently opened a Mexico City office, there has been an enormous growth in demand in the office sector, with a "crushing demand" for class A office space in Mexico City, and a strong demand for prime office space outside of Mexico City.[67] Industrial space is in even greater demand than office space,[68] and if NAFTA results in a boom in manufacturing, the demand for warehouses and factories will escalate.[69]

There are also opportunities for U.S. contractors to capitalize on the construction of basic infrastructure projects such as highways, schools, dams, ports, water treatment facilities, railroads, irrigation systems, power plants, airports, and hospitals. Since Mexico was mired in debt during the 1980s, the government invested little in infrastructure during that time.[70] The present administration, however, is committed to meeting the demand for basic infrastructure.[71]

According to Mexico's undersecretary of housing, Alfredo Phillips Olmedo, "Opportunities in Mexico are enormous. Mexico plans to modernize 100 medium-sized cities."[72] To meet its modernization plans, the Mexican government will

63. Nihill, *supra* note 56, at 8.

64. Richard Alm, *A Radical Change Among Many in Mexico*, DALLAS MORNING NEWS, Dec. 6, 1992, at 1H.

65. Nihill, *supra* note 56, at 8.

66. Alm, *supra* note 64, at 1H.

67. Charles W. Thurston, *U.S. Real Estate Brokers Scrambling for Position in Mexico*, CHI. TRIB., May 23, 1993, at 2R. Although the office vacancy rate in Mexico City increased from 1% in 1992 to 10% in 1993, this figure is lower than the 22% vacancy rate in Los Angeles and the 14% rate across the United States. David W. Myers, *NAFTA: Doing Business in Mexico; U.S. Builders See Big Opportunities Developing; Real Estate: Commercial, Residential Projects Could Be Lucrative—But Not Overnight*, L.A. TIMES, Nov. 22, 1993, at D1. Of the 2800 U.S. companies that are active in Mexico, at least 1800 have offices in Mexico City. Thurston, *supra*, at 2R.

68. Thurston, *supra* note 67, at 2R.

69. *See supra* note 267 and accompanying text.

70. Janet Duncan, *Mexico Construction Sector Booming After 80's Lull*, Reuters, July 15, 1993, *available in* LEXIS, News Library, Curnws File.

71. U.S. Dep't of Commerce, *supra* note 62, at ix.

72. Judy Schriener, *North American Barriers Tumbling*, ENGINEERING NEWS REC., May 31, 1993, at 7.

invest an estimated $100 billion in infrastructure over the next decade, including $22 billion in highway construction, $8 billion in electric generating capacity, $3 billion in water treatment facilities, and $10 billion in the telephone system.[73] With staggering figures such as these, U.S. construction firms should not overlook the opportunity to participate in Mexico's modernization effort.

IV. RULES AND REGULATIONS

Before entering the construction services market in Mexico, U.S. firms must be aware of how pertinent Mexican rules and regulations will affect their operations abroad.[74] Some of these rules and regulations include the forty-nine percent ownership rule,[75] restrictive land ownership laws,[76] labor laws,[77] rules for business organization,[78] and joint venture regulations.[79]

A. Forty-Nine Percent Ownership Rule

One of the most important restrictions affecting the participation of U.S. firms in the construction industry in Mexico is a limitation on foreign majority ownership of companies that engage in construction activities.[80] The Law to Promote Mexican Investment and Regulate Foreign Investment (1973 FIL)[81] restricted foreign ownership of almost all Mexican companies to a maximum of forty-nine percent of the capital.[82] Without amending the 1973 FIL, President

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73. Chuck Freadhoff, INVESTOR'S BUS. DAILY, Nov. 24, 1993.

74. The limited scope of this comment precludes the discussion of some pertinent rules and regulations. Omission of rules and regulations is by no means intended to imply their insignificance. To the contrary, some omitted concerns, such as Mexican tax laws, are of great importance in assessing the viability of doing business in Mexico. Thus, it is strongly recommended that competent legal counsel be consulted in the initial stages of planning to ensure that all legal ramifications are fully addressed.

75. *See infra* notes 80-90 and accompanying text.

76. *See infra* notes 91-132 and accompanying text.

77. *See infra* notes 133-63 and accompanying text.

78. *See infra* notes 164-213 and accompanying text.

79. *See infra* notes 214-52 and accompanying text.

80. *North American Free Trade Agreements, in* LAW & PRACTICE UNDER THE GATT AND OTHER TRADING ARRANGEMENTS, bk. 6, annex 1, at 33 (James R. Holbein & Donald J. Musch eds., 1993).

81. Ley Para Promover La Inversión Mexicana y Regular La Inversión Extranjero [Law to Promote Mexican Investment and Regulate Foreign Investment], D.O., Mar. 9, 1973 (repealed 1993), *translated in* MEXICAN FOREIGN INVESTMENT AND TRANSFER OF TECHNOLOGY LAWS 7 (CCH 1973) [hereinafter 1973 FIL].

82. Thomas M. Shoesmith, *Foreign Investment Regulations and Foreign Ownership and Use of Mexican Real Estate*, 1 Mex. Trade & L. Rep. (Int'l Trade Info. Corp.) No. 3 (Dec. 1991). The practical and intended effect of the 1973 FIL was to reserve majority ownership and control of businesses for Mexican investors. Reginald Davis, *Joint-Venture Subsidiaries, in* 1 DOING BUSINESS IN MEXICO 2-1, 2-4 (Michael W. Gordon ed., 1993). Although the concept of retaining majority ownership of companies for Mexican nationals was attractive, the economic crisis that started in 1982 caused the federal government to realize the importance of foreign investment for the economy, and as a result, the government sought to stimulate the influx of foreign capital by loosening the restrictions. *Id.* at 2-7.

Salinas established new foreign investment regulations in 1989 (1989 Regulations)[83] that were more favorable to foreign investors. The 1989 Regulations created categories of business activities with varying degrees of allowable foreign ownership, up to 100 percent.[84] The recently promulgated 1993 Foreign Investment Law (1993 FIL),[85] which repealed the 1973 FIL, still maintains categories of activities, although they are different from those established in the 1989 Regulations.[86] The 1993 FIL specifies that foreign investors cannot own more than forty-nine percent of firms that perform construction services in the absence of Foreign Investment Commission (FIC) approval.[87] However, the 1993

In 1984, the Mexican Foreign Investment Commission (FIC), working within the framework of the 1973 FIL, decided to allow majority foreign ownership of some Mexican corporations in several industries as an incentive to invest in the country. Shoesmith, *supra*. However, FIC approval for majority ownership was only granted on a case-by-case basis. *Id.* According to one international law attorney, "The approval process was long, convoluted, difficult to understand, and often took a year or more." *Id.*

Consistent with his liberal attitude toward foreign investment, President Salinas exercised his constitutional powers in 1989 to expand the potential for foreign majority ownership of companies and to simplify the process. *Id.*

83. Reglamento de la Ley para Promover la Inversión Mexicana Y Regular la Inversión Extranjero [Regulation of the Law to Promote Mexican Investment and Promote Foreign Investment], D.O., May 16, 1989, *translated in* TAX LAWS OF THE WORLD: MEXICO, bk. 3, at 21 (Foreign Tax Law Publishers, Inc. trans., 1994) [hereinafter 1989 Regulations].

84. Shoesmith, *supra* note 82. *See* James K. Jackson, *Will NAFTA Cause U.S. Firms to Beat a Wider Path to Mexico?*, 3 Mex. Trade & L. Rep. (Int'l Trade Info. Corp.) No. 5 (May 1993) (listing the six categories of activities under the 1989 Regulations).

85. Ley Para Promover La Inversión Mexicana y Regular La Inversión Extranjero [Law to Promote Mexican Investment and Regulate Foreign Investment], D.O., Dec. 27. 1993, *translated in* TAX LAWS OF THE WORLD: MEXICO, bk. 3, at 8 (Foreign Tax Law Publishers, Inc. trans., 1994) [hereinafter 1993 FIL]. The new 1993 FIL, which was passed quietly in late December 1993, is expected to have a significant impact on foreign investment. L.A. Mitchell, *Mexico Relaxes Foreign Investment Curbs*, ARIZ. BUS. GAZETTE, Jan. 6, 1994, at 1. According to Pedro Noyola, Mexican Undersecretary of Foreign Trade and Investment, the 1993 FIL codifies into law the principles of the investment chapter (chapter 11) of NAFTA, thereby making the principles applicable to countries outside of North America. *Mexico's Lower House Approves New Foreign Investment Law*, 10 Int'l Trade Rep. (BNA) 2134 (Dec. 22, 1993) [hereinafter *Mexico's Lower House*]. *See infra* notes 278-82 and accompanying text (discussing chapter 11 of NAFTA). The 1993 FIL also gives the deregulatory provisions of the 1989 Regulations the permanency of law. *Mexico's Lower House*, *supra*, at 2134.

One significant change in the law is that foreign investors can now own land directly in what has been known as the prohibited zone. *Id.* *See infra* notes 94-97 and accompanying text (discussing ownership of land in the prohibited zone). Another major change effected by the 1993 FIL is the opening of several industries to foreign investment which were previously limited to Mexican ownership. Mitchell, *supra*, at 1. *See* Janet Duncan, *Mexico Scrapping Limits on Foreign Investment*, CALGARY HERALD, Nov. 26, 1993, at C15 [hereinafter Duncan II] (describing some of the industries that have been opened to foreign investment). According to the Mexican Investment Board, under the 1993 FIL, the activities that account for approximately 80% of Mexico's GDP are now unrestricted. *Mexico Publishes New Law on Foreign Investment*, 11 Int'l Trade Rep. (BNA) 59 (Jan. 12, 1994).

86. *See* 1993 FIL, *supra* note 85, tit. 1, ch. 2 (listing the categories of restricted activities under the 1993 FIL).

87. 1993 FIL, *supra* note 85, transitory art. 9. One commentator lists the major factors which the FIC considers in making its determination as follows:

> The level of new jobs generated and salaries to be paid, [t]he employment and training of Mexican technicians and administrative personnel, [t]he amount of financing by foreign resources, [t]he enterprise's contribution to the development of relatively less-economically-developed zones or

FIL phases out the approval requirement.[88] As of January 1, 1999, foreigners will be able to own 100 percent of construction companies without Mexican government approval.[89] Until 1999, however, a U.S. contractor without FIC approval for majority ownership must form a joint venture with a Mexican party to engage in construction activities.[90]

B. Land Laws

Although construction firms do not need to gain an interest in real property merely to build for contract in Mexico, U.S. developers and foreign contractors who want to build for speculation must be cognizant of Mexico's land laws.

Land in Mexico falls into one of two geographic categories: prohibited zones or permissible lands.[91] Prohibited zones consist of the land that extends approximately sixty miles from the U.S.-Mexican border, and thirty miles inland from the coast,[92] while permissible lands are those lands that are not included in the prohibited zones.[93] The primary legal distinction between these land categories is the potential for foreign ownership.

Before the implementation of the 1993 FIL, foreign ownership of real property in the prohibited zone was absolutely prohibited.[94] The 1993 FIL significantly liberalizes the restriction on foreign ownership by allowing any

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> regions, [i]ts competitiveness in the national market, [i]ts impact on the country's cultural and social values, and [t]he extent to which the enterprise contributes to the attainment of and conforms with national development objectives.

David G. Ellsworth, *Regulatory Aspects of Resort Development in Mexico*, VACATION INDUSTRY REV., Jan.-Feb. 1987 [hereinafter Ellsworth I] (on file with *The Transnational Lawyer*).

88. 1993 FIL, *supra* note 85, transitory art. 9.

89. *Id.*

90. *See infra* notes 214-52 and accompanying text (discussing joint ventures).

91. *See* JOHN DE LA VEGA, MEXICAN REAL ESTATE 39-50 (1976) (discussing prohibited zones and permissible lands).

92. 1993 FIL, *supra* note 85, ch. 1, art. 2. According to the 1993 FIL, the restricted or prohibited zone is "[t]he strip of national territory of 100 kilometers along the length of the frontiers and of 50 kilometers along the length of the beaches." *Id.*

93. DE LA VEGA, *supra* note 91, at 40.

94. *Id.* at 38. The Mexican Constitution provides:

> Only Mexicans by birth or naturalization and Mexican companies have the right to acquire ownership of lands, waters[,] and their appurtenances, or to obtain concessions for the exploitation of mines or of waters. The State may grant the same right to foreigners, provided they agree before the Ministry of Foreign Relations to consider themselves as nationals in respect to such property, and bind themselves not to invoke the protection of their governments in matters relating thereto; under penalty, in case of noncompliance with this agreement, of forfeiture of the property acquired to the Nation. Under no circumstances may foreigners acquire direct ownership of lands or waters within a zone of one hundred kilometers along the frontiers and of fifty kilometers along the shores of the country.

CONSTITUCIÓN POLÍTICA DE LOS ESTADOS UNIDOS MEXICANOS [Constitution] art. 27 (amended 1960) (Mex.), *translated in* CONSTITUTIONS OF THE COUNTRIES OF THE WORLD 88 (Albert P. Blaustein & Gisbert H. Flanz trans., 1982) [hereinafter MEX. CONST.].

corporation established in Mexico with a Mexican address to acquire fee title to land in the prohibited zone if the property is to be used for nonresidential purposes.[95] Thus, a U.S. developer with FIC approval for majority ownership can now establish a corporation in Mexico and purchase land in fee for commercial development, thereby eliminating lingering uncertainties in the land title.[96] Foreigners and Mexican companies with foreign ownership still cannot own property in fee in the prohibited zone if the property is intended for residential use.[97]

As for the permissible lands, article 27 of the Mexican Constitution forbids foreign ownership unless permission is granted by the secretary of foreign affairs.[98] Such permission will only be granted if the foreigner satisfies certain immigration requirements.[99] Because of the unlikely possibility that a U.S. investor will meet the requirements of the immigration laws, the Mexican Constitution effectively prohibits U.S. investors from acquiring fee or legal title to permissible land.[100] Since Mexican law restricts foreign fee ownership of permissible land and land in the prohibited zone that is to be used for residential purposes, a developer must understand how a foreign investor can gain the beneficial use of real property without violating legal restrictions on fee ownership. One way to accomplish this is through the creation of a *fideicomiso*, or Mexican bank trust.[101] The *fideicomiso* is similar to a trust used in the United States in that it

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95. *Mexico's Lower House Approves New Foreign Investment Law*, *supra* note 85, at 2134. The 1993 FIL states that "[i]n the case of companies whose by-laws include the convention provided in item I of Constitutional Article 27, the following shall apply: I. They may acquire ownership of real property located in the restricted zone, intended for the carrying out of non-residential activities." 1993 FIL, *supra* note 85, tit. 2, ch. 1, art. 10. The "convention in item I of Constitutional Article 27" referred to above is a statement by the foreign owners of the company that they will consider themselves as Mexican nationals in regard to the property; thus, any disputes involving the property will be resolved in Mexico, not the foreigners' native countries. Mitchell, *supra* note 85, at 1. *See supra* note 94 (text of item I of art. 27).

96. Mitchell, *supra* note 85, at 1.

97. 1993 FIL, *supra* note 85, tit. 2, ch. 1, art. 10.

98. DE LA VEGA, *supra* note 91, at 40.

99. *Id.* To own real property, the foreigner must meet the requirements of either *inmigrante* or *inmigrado* status. *Id.* An *inmigrante* is someone who comes to Mexico to grow roots, intending to become a permanent resident and obtain *inmigrado* status. ALBERTO MAYAGOITIA, A LAYMAN'S GUIDE TO MEXICAN LAW 37-38 (1976). A foreigner will be accepted as an *inmigrante* for five years, during which time he must prove annually to the *secretaria de gobernacion* that he is fulfilling the requirements set forth in the permit that authorized him to stay. *Id. See also id.* at 39 (listing the requisites for a foreigner to become an *inmigrante*). "An inmigrante should not be out of the country more than eighty-nine days each year during the first two years and no more than eighteen months during the first five years. If he exceeds this limit, he will lose his permit." *Id.* "To achieve the status of *inmigrado* the foreigner must have had legal residence in the country as *inmigrante* for five years, have observed all the laws, and have pursued all his activities honestly and 'socially positively.'" DE LA VEGA, *supra* note 91, at 40.

100. *See* DE LA VEGA, *supra* note 91, at 39.

101. David G. Ellsworth, *Mexico Welcomes Foreign Tourist Development*, URBAN LAND, Aug. 1991 [hereinafter Ellsworth II] (on file with *The Transnational Lawyer*). *See* 1993 FIL, *supra* note 85, tit. 2, ch. 2, art. 11 (text of law pertaining to trusts on property in the restricted zone). The *fideicomiso* is essentially a legal fiction to get around the constitutional restriction on foreign ownership. David G. Ellsworth, *Investing in*

involves three parties: the trustor, trustee, and beneficiary.[102] The trustor is the seller of the property, and the trustee, who will hold legal title to the land, must be an authorized credit institution, usually a bank.[103] The investor, as the beneficiary of the trust, has all rights of ownership, including the right to sell, lease, bequeath, or improve the property.[104]

To establish the trust in favor of the beneficiary, the seller and the bank representative appear before a notary public.[105] At this meeting, the seller is required to present a certificate of ownership and evidence that there are no unpaid taxes or outstanding utility bills.[106] In addition, a current appraisal of the property must be presented, and the buyer must show that he has obtained the requisite permit from the secretary of foreign relations.[107] When all the documents are presented, the trust contract is executed.[108]

Although prior to 1989 a *fideicomiso* could only be effective for a thirty-year period,[109] the 1989 Regulations provided for guaranteed renewal for an additional thirty years,[110] as long as a timely application for renewal of the trust was filed with the secretary of foreign affairs.[111] The new 1993 FIL extends the original term of trusts from thirty to fifty years and still allows renewal of the trust.[112]

Mexican Real Estate, 1 Sw. Bull. (U.S.-Mex. Chamber Com.) No. 1 (Jan. 1989) [hereinafter Ellsworth III] (on file with *The Transnational Lawyer*).

102. DE LA VEGA, *supra* note 91, at 49.

103. *Id.*

104. Caty Van Housen, *California Fizzle Pours Cold Water on Mexico's Sizzle*, SAN DIEGO BUS. J., Aug. 9, 1993.

105. DE LA VEGA, *supra* note 91, at 49-50. Mexican notaries public must be licensed attorneys who are also licensed to act in a notary capacity. *Id.* at 42. Notaries public are also legally obligated to participate in all real property transfers. Fernando Orrantia, *Conceptual Differences Between the Civil Law System and the Common Law System*, 19 SW. U. L. REV. 1161, 1168 (1990). They have very different responsibilities than notaries public in the United States. *Id.* Whereas U.S. notaries merely authenticate and certify signatures, Mexican notaries act as impartial advisers to both parties to a contract of sale. *Id.* They draw up the contract, examine the title, inform the parties of the legal consequences of the contract, and ensure that the transfer is carried out without undue advantage to either party. *Id.*

106. DE LA VEGA, *supra* note 91, at 50.

107. *Id.* *See infra* notes 130-32 and accompanying text (discussing permits for *fideicomisos*).

108. DE LA VEGA, *supra* note 91, at 50. Most banks have their own trust agreement forms; no standard form is required. *Id.* at 49. *See id.* app. B (providing a sample trust form).

109. 1973 FIL, *supra* note 81, ch. 4, art. 20.

110. 1989 Regulations, *supra* note 83, ch. 3, art. 20.

111. *Id.* art. 20. A new trust permit must be granted for another 30 years as long as an application is filed no less than 181 days, nor more than 360 days, prior to the expiration of the original term. David G. Ellsworth, *Mexico Makes It Easier*, 7 Int'l Timeshare News No. 6 (1990) [hereinafter Ellsworth IV] (on file with *The Transnational Lawyer*).

112. 1993 FIL, *supra* note 85, tit. 2, ch. 2, art. 13. Article 13 of the 1993 FIL says "The duration of the trusts to which this chapter refers shall be for a maximum period of 50 years, which may be extended upon petition of the interested party." *Id.* However, it is not clear from the language of this provision if the trust will be extended for another 50 years, or some other period. Since the 1989 Regulations specifically provided that the 30-year trust term will be renewed for another 30-year period, 1989 Regulations, *supra* note 83, ch. 3, art. 20, and the 1993 FIL provides that the 1989 Regulations continue in force to the extent that they are not incon-

The primary benefit of guaranteed renewal of the *fideicomiso* is that it assures foreigners that they may use the real property on a long-term basis.[113] Before the right of guaranteed renewal, investors were leery of acquiring an interest in property that they would have to relinquish in thirty years.[114] Investors take greater comfort now in knowing that they can operate their property well into the future.[115]

Investors also benefit from guaranteed renewal because lenders appreciate the prospect of long-term use of real property.[116] Before the 1989 Regulations guaranteed renewal, lenders were hesitant to lend for permanent improvements such as hotels and shopping centers because of the limited marketability of the balance of a thirty-year beneficial interest.[117] For example, if there were only ten years left before the expiration of the term, a lender who foreclosed on a property would realistically be limited to selling only to a Mexican national who could purchase the property in fee, since the remaining ten-year term might not be sufficiently valuable to a foreign investor.[118] According to the 1989 Regulations, if a trust is sold, the new buyer will automatically be issued a full thirty-year term to use and enjoy the property,[119] whereas prior to 1989, a foreign purchaser could only acquire the remainder of the beneficial interest in the trust.[120]

In establishing and maintaining a *fideicomiso*, a U.S. investor will incur certain costs[121] which may influence what the investor is ultimately willing to pay for a beneficial interest. At a minimum, the investor will incur bank trust fees, notary fees, and title insurance fees, in addition to his obligation to pay the full purchase price.[122] Bank trust fees are typically one percent of the value of the property per year and are payable in advance, quarterly or semiannually.[123] One can expect to pay notary fees of one to two percent of the purchase price for basic notary services, and more if extra services are required.[124] Total initial

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sistent with the 1993 FIL, 1993 FIL, *supra* note 85, transitory art. 4, it is possible to read the two laws to mean that the new 50-year term will only be renewed for an additional 30-year term, rather than another 50-year term.

113. Ellsworth IV, *supra* note 111.

114. *See* David G. Ellsworth, *Mexico Invites Foreign Investors in Tourism*, DEVELOPMENTS, Sept. 1990, at 3 [hereinafter Ellsworth V] (on file with *The Transnational Lawyer*).

115. *Id.*

116. Ellsworth IV, *supra* note 111.

117. *Id.*

118. *Id.*

119. *Id. See* 1989 Regulations, *supra* note 83, ch. 3, art. 21 (providing for the issuance of a new term). This provision is still effective since the 1993 FIL makes no contrary provision.

120. Jorge Camil, *Mexico's 1989 Foreign Investment Regulations: The Cornerstone of a New Economic Model*, 12 HOUS. J. INT'L L. 1, 17 (1989).

121. DE LA VEGA, *supra* note 91, at 50. U.S. investors should be aware that a transfer tax equal to 10% of the value of the property will be assessed when they sell the property. Orrantia, *supra* note 105,-at 1168.

122. DE LA VEGA, *supra* note 91, at 50.

123. *Id.*

124. *Id.*

bank and notary fees may be in the order of six to eight percent of the purchase price.[125] Additional fees may be incurred if other services, such as those of attorneys or brokers, are needed.[126] As for title insurance, fees in Mexico are typically seventy-five percent higher than in the United States.[127] One estimate puts total expenses for the entire transaction at 11.5 to 12.5 percent of the purchase price.[128] A purchaser of a beneficial interest should bear in mind that, as in the United States, either party to the transaction may pay the required costs.[129]

If the real property falls within the prohibited zones or the territory of Baja California, a foreign investor must obtain a permit from the Mexican Ministry of Foreign Relations to become a party to a *fideicomiso*.[130] A permit will almost certainly be granted if the property is to be used for a commercial, industrial, or tourism purpose, or if the property is less than fifty acres.[131] If the property will not be used for one of these purposes and is more than fifty acres, the project must pass the discretionary review of the National Foreign Investment Commission before a permit will be granted.[132]

C. Labor Laws

U.S. contractors who enter the construction services market in Mexico will likely use Mexican labor because it is less costly than U.S. labor.[133] Therefore, contractors must understand the state of labor relations in Mexico. In particular, it is important to recognize that labor relations in Mexico are highly regulated and that Mexican workers generally have greater rights than their U.S. counterparts.[134]

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125. *Id.*
126. *Id.*
127. *Id.*
128. MAYAGOITIA, *supra* note 99, at 18.
129. DE LA VEGA, *supra* note 91, at 50.
130. Ellsworth IV, *supra* note 111. *See* 1993 FIL, *supra* note 85, tit. 2, ch. 2, art. 11.
131. Ellsworth IV, *supra* note 111. The 1989 Regulations state that residential development is considered an industrial or tourist activity. *See* 1989 Regulations, *supra* note 83, tit. 3, ch. 3, art. 19 (listing the activities that are considered tourist and industrial activities).
132. Ellsworth IV, *supra* note 111.
133. *See* Jorge A. De Regil, *The Mexican Work Force*, *in* INVESTING IN MEXICO, *supra* note 12, at 21, 22. The minimum wage in Mexico varies from region to region, ranging in 1991 from $3.60 per day to $4.25 per day. *Id.* However, "It is impossible to hire anyone at minimum wage in Mexico; they just will not work for you." *Id.* In actuality, the average daily wage in Mexico in August 1991 was $9.60, which is twice the minimum wage. *Id.* This is significantly lower than the daily wage of approximately $34 in the United States, assuming an 8-hour day at $4.35 per hour. Since construction workers in the United States generally do not work for minimum wage either, the disparity in wages is actually greater than that represented by this comparison on minimum wages.
134. Mark E. Zelek & Oscar de la Vega, *An Outline of Mexican Labor Law*, *in* 1 DOING BUSINESS IN MEXICO, *supra* note 82, at 1-1, 1-2. It is outside the scope of this comment to address the extent to which Mexican labor laws are actually observed and enforced.

The parameters for Mexican labor law are set forth in article 123 of the Mexican Constitution,[135] which deals with worker rights, labor legislation, and the operation of the social security system.[136] Within the parameters established by the constitution, the first Federal Labor Law was enacted in 1931.[137] However, this was subsequently replaced by the 1970 Federal Labor Law which further enhanced working conditions.[138] The 1970 Federal Labor Law still reflects socialist ideas popular at the turn of the century and thus embodies many labor-oriented principles and a protectionist spirit.[139] Some of these labor-oriented provisions include a maximum eight-hour work day;[140] a maximum six-day work week;[141] maximum overtime of three hours per day, but no more than three days per week;[142] a minimum working age of fourteen years;[143] and full maternity rights.[144] Other worker rights, discussed more fully below, include employment for an indefinite term, mandatory fringe benefits, mandatory profit sharing, and collective bargaining rights.[145]

An important principle reflected in Mexican labor law is job stability.[146] With job stability as its underlying principle, the 1970 Federal Labor Law assumes that employment agreements are for an indefinite term, unless the work to be performed is temporary in nature or one worker is temporarily substituting for another worker.[147] When the employment relationship is for an indefinite term, a worker can only be laid off for cause.[148] This is quite a different ap-

135. MEX. CONST., *supra* note 94, art. 123.

136. De Regil, *supra* note 133, at 21. Mexico was the first country in world history to recognize labor rights in its constitution. Zelek & de la Vega, *supra* note 134, at 1-2.

137. Zelek & de la Vega, *supra* note 134, at 1-2.

138. *Id. See* Ley Federal del Trabajo [Federal Labor Law], D.O., *translated in* COMMERCIAL LAWS OF THE WORLD; MEXICO: LABOR LAWS 1 (Foreign Tax Law Publishers, Inc., 1993) [hereinafter 1970 Federal Labor Law].

139. De Regil, *supra* note 133, at 21.

140. 1970 Federal Labor Law, *supra* note 138, para. 61.

141. *Id.* pt. 3, ch. III, para. 69.

142. *Id.* ch. II, para. 66.

143. *Id.* pt. 2, ch. I, para. 22.

144. *See id.* pt. V, para. 170 (discussing maternity rights).

145. *See* Zelek & de la Vega, *supra* note 134, at 1-3 to 1-7.

146. *Id.* at 1-3.

147. *Id.* Since a single construction project is temporary in nature, it appears from the language of these provisions that a contractor is permitted to hire a worker only for the duration of the project. The 1970 Federal Labor Law states specifically that "[t]he employment relation shall be for a specified piece of work or of specified duration, or of unspecified duration. In the absence of any express stipulation the relation shall be deemed to be of unspecified duration." 1970 Federal Labor Law, *supra* note 138, para. 35. It states further that "[a] contract for a specified piece of work may be made only when such contract is required by the nature of the work." *Id.* para. 36.

148. Zelek & de la Vega, *supra* note 134, at 1-3.

> Article 47 of the Federal Labor Law enumerates specific kinds of conduct that are cause for dismissal: (1) use of false documentation to secure employment; (2) dishonest or violent behavior on the job; (3) dishonest or violent behavior against co-workers that disrupts work discipline; (4) threatening, insulting, or abusing the employer or his family, unless provoked or acting in self-

proach than that prevalent in the United States, where the general rule is employment-at-will.[149]

In addition to the guarantee of job stability, Mexican workers are entitled to several fringe benefits. For example, workers are entitled to a Christmas bonus equivalent to fifteen days' wages.[150] Employers in Mexico must also provide workers with a minimum yearly vacation period of six days, with an additional two days, up to a maximum of twelve, for each year of employment after the first year.[151] During vacation periods, workers receive their full wages plus a twenty-five percent vacation premium.[152] In addition to vacation days, there are seven official paid holidays in Mexico.[153]

Employers in Mexico must also include workers in profit sharing at a rate determined by the National Profit Sharing Commission.[154] In prior years, the rate has been ten percent of the employer's taxable income.[155] To prevent financial hardship on new businesses, newly established companies are exempt from the profit-sharing requirement during their first year of operation;[156] therefore, U.S. contractors will not have to share profits the first year that they do business in Mexico.

In addition to sharing profits with employees, employers are required to contribute an amount equal to five percent of the earnings of their employees into a national housing fund.[157] Money from this fund is used to grant loans to employees to build, buy, or repair homes, or to repay existing debts incurred for such purposes.[158]

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defense; (5) intentionally damaging the employer's property; (6) negligently causing serious damage to the employer's property; (7) carelessly threatening workplace safety; (8) immoral behavior in the workplace; (9) disclosure of trade secrets or confidential information; (10) more than three unjustified absences in a thirty-day period; (11) disobeying the employer without justification; (12) failure to follow safety procedures; (13) reporting to work under the influence of alcohol or nonprescription drugs; (14) a prison sentence; or (15) commission of other acts of similar severity to those described above.

Id. at 1-4. 1970 Federal Labor Law, *supra* note 138, ch. IV, para. 47.

149. Zelek & de la Vega, *supra* note 134, at 1-3.

150. Louis R. Barnetche & Guillermo Diaz de Rivera, *International Joint Ventures in Mexico*, *in* 2 JOINT VENTURES WITH INTERNATIONAL PARTNERS 23-1, 23-28 (James A. Dobkin & Jeffrey A. Burt eds., 1991). 1970 Federal Labor Law, *supra* note 138, para. 87 (amended Dec. 30, 1975).

151. 1970 Federal Labor Law, *supra* note 138, para. 76. After five years of employment, employees get two extra days for every five years of work. De Regil, *supra* note 133, at 21.

152. 1970 Federal Labor Law, *supra* note 138, para. 80.

153. Barnetche & Diaz de Rivera, *supra* note 150, at 28. The paid federal holidays in Mexico are January 1, February 5, March 21, May 1, September 16, November 20, December 25, and December 1 every six years, when the president takes office. 1970 Federal Labor Law, *supra* note 138, para. 74.

154. Zelek & de la Vega, *supra* note 134, at 1-5; 1970 Federal Labor Law, *supra* note 138, para. 117.

155. De Regil, *supra* note 133, at 22.

156. Zelek & de la Vega, *supra* note 134, at 1-5 to 1-6; 1970 Federal Labor Law, *supra* note 138, para. 126.

157. 1970 Federal Labor Law, *supra* note 138, para. 136. This fund is administered by the National Workers' Housing Fund Institute (INFONAVIT). PRICE WATERHOUSE, DOING BUSINESS IN MEXICO 108 (1991).

158. PRICE WATERHOUSE, *supra* note 157, at 108.

Union activity is encouraged more in Mexico than it is in the United States,[159] and workers are encouraged to seek improvements in working conditions through collective bargaining agreements negotiated by unions.[160] Collective bargaining agreements may be executed by workers' unions and employers as long as they do not diminish workers' rights as secured by the 1970 Federal Labor Law.[161] A company in Mexico without a union can be forced to accept a collective bargaining agreement even if only one of the union's members is employed by the company.[162] Furthermore, the provisions of the collective bargaining agreement cover all employees, even those who are not union members.[163]

D. Business Organization

An important consideration for a foreign contractor or developer is what organizational form the business should take. In Mexico, business associations are governed by the General Law of Mercantile Companies (Mercantile Law).[164] In addition to specifying the information that organizational documents must contain,[165] the Mercantile Law governs the operation of branches of foreign companies and also establishes six types of business associations.[166]

The Mercantile Law allows an existing U.S. business organization to operate as a branch in Mexico if the company obtains authorization from the Department of National Economy and registers in the Public Commercial Registry.[167] Although obtaining approval is not difficult,[168] there are several disadvantages

159. *See* De Regil, *supra* note 133, at 22.
160. Zelek & de la Vega, *supra* note 134, at 1-6.
161. *Id.* at 1-6 to 1-7; 1970 Federal Labor Law, *supra* note 138, para. 394.
162. De Regil, *supra* note 133, at 22; 1970 Federal Labor Law, *supra* note 138, para. 387.
163. Zelek & de la Vega, *supra* note 134, at 1-7; 1970 Federal Labor Law, *supra* note 138, para. 396.
164. Ley General de Sociadades Mercantiles [General Law of Mercantile Companies], D.O., Aug. 4, 1934 (amended Aug. 28, 1934), *translated in* COMMERCIAL LAWS OF THE WORLD: MEXICO, bk. 4, at 290 (Foreign Tax Law Publishers, Inc. trans., 1993) [hereinafter Mercantile Law]. The Mercantile Law is sometimes referred to as the General Law on Business Entities.
165. Beverly M. Carl, *Mexican Law on Business Associations*, *in* 1 DOING BUSINESS IN MEXICO 1-1, 1-3 (Michael W. Gordon ed., 1993).
166. *Id.* at 1-4.
167. *Id.* at 1-5.
168. The Mercantile Law provides:

> To obtain authorization from the Ministry of Economy to enable the firm to register [as a branch], the following procedure must be followed: The company must first prove that it was organized in conformity with U.S. Law, by presenting a copy of its corporation charter and by-laws and all other authenticated documents concerning its formation. It also must present a certificate from the nearest Mexican Consular or diplomatic official to the effect that the company has been lawfully organized according to U.S. Law. Authentication and certification are accomplished by obtaining certified copies from the proper officials under U.S. Jurisdiction where the company's documents are registered. If the document to be authenticated has not been registered in a government office, then the company's secretary must prepare copies whose signature is verified by a notary public. The notary public must state his jurisdiction and also state that he examined the company's records and

to operating as a branch in Mexico that prevent the branch from being the preferred vehicle for doing business.[169] In addition to various tax disadvantages[170] and restrictions on owning real property,[171] operating as a branch is disfavored because the company's Mexican operations might expose the company's U.S. assets to foreign judgment.[172] Also, due to the 1993 FIL limits on foreign ownership discussed above,[173] a U.S. construction firm will not be able to operate in Mexico as a branch unless FIC approval is obtained or until the approval requirement is phased out in 1999.[174]

Due to these disadvantages, a U.S. developer may choose to organize a new business in Mexico. Such a business may take one of the following forms: a general partnership,[175] limited partnership,[176] limited partnership with shares,[177] limited liability company,[178] or corporation.[179] In addition, a

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> that he knows the executing (secretary) to hold his respective office, and he has the power to certify for the company. An appropriate State Official must then authenticate the signature of the notary. All the authenticated documents must be presented to the Mexican Consul in the district. The consul will authenticate the signature of the State Official of the U.S. and issue a certificate that the company has been constituted in accordance with the laws of the State.

Mercantile Law, *supra* note 164, ch. I (translator's comment).

169. Carl, *supra* note 165, at 1-5.

170. *Id.* Under the Income Tax Law, branches of nondomiciled foreign corporations receive less favorable tax treatment primarily because of their inability to deduct charges for management services, royalties, and interest of the head office and inability to exchange losses on intracompany debts of the branch. PRICE WATERHOUSE, *supra* note 157, at 94.

171. *See* MEX. CONST., *supra* note 94, art. 27 (amended 1960) (discussing legal capacity to own land). "Foreign corporations which have no Mexican domicile are absolutely prohibited from owning land in Mexico, whether through a trust or otherwise." Shoesmith, *supra* note 82.

172. Mercantile Law, *supra* note 164, ch. I (translator's comment).

173. *See supra* notes 81-90 and accompanying text (discussing the 49% ownership rule).

174. *See infra* notes 274-75 and accompanying text (discussing the phasing out of the 49% ownership rule for construction companies).

175. Carl, *supra* note 165, at 1-6. *See id.* (discussing the characteristics of general partnerships). According to the Mercantile Law, "A general partnership is an association which trades under a business name and in which all the partners are liable in a subsidiary, unlimited and joint manner for business obligations." Mercantile Law, *supra* note 164, art. 25. *See id.* ch. II (complete text of the Mercantile Law pertaining to general partnerships).

176. Carl, *supra* note 165, at 1-7. *See id.* (discussing the characteristics of limited partnerships). The Mercantile Law provides:

> Special [limited] partnership (partnership en commandite) is that which exists under a trading name and which is formed by one or more financed or active partners who are liable in a subsidiary, unlimited and joint manner for all the business obligations of the firm, and one or more financing or dormant partners whose sole obligation consists in the payment of their respective contributions to the capital.

Mercantile Law, *supra* note 164, art. 51. *See id.* ch. III (complete text of the Mercantile Law pertaining to limited partnerships).

177. Carl, *supra* note 165, at 1-8. *See id.* (discussing the characteristics of limited partnerships with shares). According to the Mercantile Law, "Special partnerships with shares shall be composed of one or more financed (working) partners who are liable in a subsidiary, unlimited and joint manner for obligations incurred by the partnership, and one or more financing partners whose liability is limited to payment of their shares." Mercantile Law, *supra* note 164, ch. VI, art. 207. *See id.* ch. VI (complete text of the Mercantile Law pertaining to limited partnerships with shares).

developer who organizes the business in one of these forms may elect to establish the firm as a company with a variable capital.[180]

General and limited partnerships in Mexico are similar to their counterparts in the United States.[181] In a limited partnership with shares, the partners' ownership interests are represented by shares of stock which can only be transferred with the permission of two-thirds of the limited partners and the unanimous consent of the general partners.[182] The general partners in all three types of partnership have unlimited liability.[183] Partnerships are taxed as separate entities in Mexico, thus investors do not get the advantage of the pass-through tax treatment that makes partnerships popular in the United States.[184]

The two business forms used most frequently by foreign investors are the limited liability company and the corporation.[185] The limited liability company, which has characteristics similar to both partnerships and corporations,[186] is somewhat analogous to a closely held corporation in the United States. It is an attractive form of business organization primarily because the liability of members is limited to their contributions.[187] The Mercantile Law requires that limited liability companies have no more than fifty members.[188] These members hold undivided interests in the company in proportion to their capital contributions.[189]

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178. Carl, *supra* note 165, at 1-9. *See id.* at 1-9 to 1-13 (discussing the characteristics of limited liability companies). The Mercantile Law provides:

> Limited liability companies are those formed by associates whose obligations are limited to the payment of their contributions to the capital but in which the capital shares cannot be represented by negotiable certificates, whether 'order' or 'bearer,' and such contributions being transferable only in the cases and with the requisites laid down in this law.

Mercantile Law, *supra* note 164, ch. IV, art. 58. *See id.* ch. IV (complete text of the Mercantile Law pertaining to limited liability companies).

179. Carl, *supra* note 165, at 1-14. *See id.* at 1-14 to 1-28 (discussing the characteristics of corporations). According to the Mercantile Law, "A joint stock company [corporation] is that which operates under a company name and is formed exclusively by stockholders whose liability is limited to paying for their shares." Mercantile Law, *supra* note 164, ch. V, art. 87. *See id.* ch. V (complete text of the Mercantile Law pertaining to corporations).

180. Carl, *supra* note 165, at 1-29. *See id.* at 1-29 (discussing the characteristics of companies with a variable capital). *See* Mercantile Law, *supra* note 164, ch. VIII, arts. 213-21 (complete text of the Mercantile Law pertaining to companies with a variable capital).

181. Carl, *supra* note 165, at 1-4.

182. *Id.* at 1-8.

183. PRICE WATERHOUSE, *supra* note 157, at 92.

184. Rona R. Mears, *Joint Ventures in Mexico: A Current Perspective*, 23 ST. MARY'S L. J. 611, 635 (1992). In Mexico, all business entities are taxed as separate entities. *Id.*

185. Carl, *supra* note 165, at 1-4.

186. *Id.* at 1-9.

187. *Id.* A person will not get the protection of limited liability if he allows his name to appear in the company's name. *Id.* Rather, he will be liable for the company's debts up to an amount equal to the largest capital contribution. *Id.*

188. Mercantile Law, *supra* note 164, ch. IV, art. 61.

189. Carl, *supra* note 165, at 1-9.

To form a limited liability company, there is a minimum total capital requirement of 3 million pesos, and each member's interest must have a value of at least 1000 pesos.[190] A minimum of half of each member's interest must be paid in at the time of formation.[191] If there is a capital increase, existing members of the company have a preferential right to acquire the newly issued interests in proportion to their present ownership.[192] Unless the agreement of association provides otherwise, a member of a limited liability company must obtain the consent of the associates representing a majority of the capital stock before he can transfer his ownership interest.[193] Similarly, majority consent is necessary before a new member can acquire an interest.[194] If the transfer of an interest to an outsider is authorized, the existing members have fifteen days to exercise a preferential right to acquire the interest.[195]

Although the limited liability company is very similar to a corporation, notwithstanding restrictions on the transferability of ownership and a maximum number of members, the corporation is by far the most popular organizational form in Mexico.[196] The attractiveness of the corporate form stems from the limited liability of shareholders and the transferability of ownership.

Although formation and organization of a corporation in Mexico closely resembles corporate formation and organization in the United States,[197] there are differences. Establishing a Mexican corporation requires at least two shareholders and a minimum capital investment of 50 million pesos.[198] In addition, authorization to establish a corporation must be obtained from the Ministry of Foreign Affairs.[199] The written authorization will state the purposes of the corporation and, if ownership of shares by foreigners is permitted, include a statement known in Mexico as the Calvo Clause.[200] This clause states that all foreign shareholders must regard themselves as Mexican nationals as far as their stock ownership is concerned; thus, foreigners cannot invoke the protection of their governments in

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190. Mercantile Law, *supra* note 164, ch. IV, art. 62. Mexico changed its currency last year from the peso to the "new peso." Jayne Clark, *Hot Spots in Puerto Vallarta, Some Things, Like Hopping Night Life, Never Change*, CHI. TRIB., Jan. 30, 1994, at C3. The new peso is 1000 times the value of the peso. *Id.* Thus, 3 million pesos is the equivalent of 3000 new pesos. At the exchange rate of 3.10 new pesos per dollar on February 9, 1994, this is the equivalent of approximately $960. *See* WALL ST. J., Feb. 10, 1994, at C10.

191. Mercantile Law, *supra* note 164, ch. IV, art. 64.

192. *Id.* ch. IV, art. 72.

193. *Id.* art. 65.

194. *Id.*

195. *Id.* art. 66.

196. JAMES E. HERGET & JORGE CAMIL, AN INTRODUCTION TO THE MEXICAN LEGAL SYSTEM 63 (1978).

197. *Id.* at 64. If there is minority foreign ownership, formation of a new Mexican corporation takes about three or four weeks. PRICE WATERHOUSE, *supra* note 157, at 86.

198. Mercantile Law, *supra* note 164, ch. V, pt. I, art. 89. This is the equivalent of approximately $16,000 at an exchange rate of 3.10 new pesos per dollar on February 10, 1994. WALL ST. J., *supra* note 190, at C10.

199. PRICE WATERHOUSE, *supra* note 157, at 86.

200. *Id.*

matters connected with their stock ownership.[201] After the Ministry of Foreign Affairs grants authorization, the corporation comes into existence when the corporate charter and bylaws are certified by a notary public and entered in the Commercial Register.[202]

An interesting difference between Mexican and U.S. corporations is the existence of one or more *comisarios* in Mexican corporations.[203] *Comisarios* are "official watchdogs" elected by the shareholders to oversee the activities of the directors.[204] The *comisario* cannot be an employee of the company or a close relative of a director, nor can he or she be an employee of another company that owns more than twenty-five percent of the corporation.[205] Although the *comisario* has no management authority,[206] he or she is responsible for inspecting the corporation's records and books at least once a month and reporting any irregularities to the shareholders.[207] In addition, the *comisario* must review the financial statements of the corporation and attend meetings of the board of directors.[208] In sum, the *comisario* has the authority to engage in general surveillance over the corporation.[209]

In most instances, Mexican companies have a fixed capital.[210] However, any company organized in one of the preceding five organizational forms can be established as a variable capital company, and thus "may also have variable capital for which shares or interest may be authorized and held by the company to be subscribed and paid for when and if needed."[211] The advantage of organizing as a variable capital company is flexibility; the organizational documents do not need to be amended to increase or decrease the variable portion of the firm's capital.[212] If a company uses the variable capital structure, its name must be followed by the words "capital variable" or the abbreviation "C.V."[213]

201. *Id.*
202. *Id.*
203. Mercantile Law, *supra* note 164, ch. V, pt. IV, art. 164. "Vigilance over a joint stock company [corporation] shall be entrusted to one or more stockholders' Auditors ('comisarios') whose appointment shall be temporary and revocable, and who may be either stockholders or not." *Id.*
204. HERGET & CAMIL, *supra* note 196, at 64.
205. Carl, *supra* note 165, at 1-26. *See* Mercantile Law, *supra* note 164, ch. V, pt. IV, art. 165 (stating who may not act as *comisarios*).
206. HERGET & CAMIL, *supra* note 196, at 64.
207. *See* Mercantile Law, *supra* note 164, ch. V, pt. IV, art. 166 (listing the powers and duties of *comisarios*).
208. Carl, *supra* note 165, at 1-26.
209. *Id.*
210. *Id.* at 1-29.
211. *Id.*
212. *Id.* "In companies having variable capital, the capital may be increased by subsequent contribution of the associates or by the admission of new associates, or diminished by the partial or total withdrawal of contributions, without further formalities than those set forth in this Chapter." Mercantile Law, *supra* note 164, art. 213.
213. Carl, *supra* note 165, at 1-29.

E. Joint Ventures

A large majority of foreign investment in Mexico is facilitated through joint venture business enterprises.[214] In the construction industry, U.S. builders frequently engage in joint ventures with Mexican companies, with all subcontracting done by Mexican firms.[215] This section discusses the benefits to a U.S. contractor of engaging in a joint venture with a Mexican party, and examines the types of joint venture arrangements that the parties can use to structure their joint undertaking.

1. Benefits of a Joint Venture

International joint ventures can be beneficial to both the national and foreign parties to the arrangement. In addition to the joint venture's usefulness as a mechanism to comply with legal restrictions on majority foreign ownership,[216] there are other benefits. These benefits include the ability to pool financial resources, share business risks,[217] combine expertise, and share technology, thereby expanding the opportunities and capabilities of both parties.[218]

A benefit of joint venturing that is of particular importance to a U.S. contractor is the opportunity to work together with a Mexican party who is knowledgeable about local business customs and who can help bridge the cultural gap.[219] A Mexican party who is already experienced in the construction industry in Mexico will likely have established working relationships with subcontractors, government officials, and material suppliers which he can bring to the venture. In addition, a Mexican partner who is familiar with the construction process and its attendant rules and regulations in Mexico should be more adept than a foreigner at guiding projects through to a timely completion.

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214. Davis, *supra* note 82, at 2-1, 2-4. Ordinarily "joint venture" is defined as a "joint undertaking of a particular transaction for mutual profit," which contemplates effecting only a single transaction. BLACK'S LAW DICTIONARY 839 (6th ed. 1990). For the purposes of this comment, however, this term will be used in a more general sense to refer to any joint business undertaking, regardless of duration.

215. Van Housen, *supra* note 104, at 17.

216. *See supra* notes 80-90 and accompanying text (discussing the 49% ownership rule).

217. PACIFIC RIM ADVISORY COUNCIL, INTERNATIONAL TECHNOLOGY JOINT VENTURES IN THE COUNTRIES OF THE PACIFIC RIM 4 (James A. Dobkin ed., 1988).

218. *Id.* at 5.

219. *See* Mears, *supra* note 184, at 623 (discussing the benefits of joint ventures in Mexico).

2. *Types of Joint Venture Arrangements*

There are two basic categories of joint ventures: equity joint ventures and contractual joint ventures.[220] While an equity joint venture entails the creation of a separate business entity to carry out the investors' objectives, a contractual joint venture does not.[221] Thus, when a U.S. contractor and Mexican partner decide to engage in a joint business undertaking,[222] they can choose to either enter into a joint venture contract[223] or form a separate business entity.[224]

If the parties[225] opt to enter into a joint venture contract, they must execute a written agreement[226] establishing "a profit-sharing association."[227] Although the term profit-sharing association seems to indicate that such an association is a business entity, no separate entity is created by a joint venture contract.[228] Therefore, unlike a corporation, a profit-sharing association has no legal personality.[229] Instead, the joint venture agreement merely establishes a contractual arrangement between the two parties, with the venture operating under the name of the Mexican managing party.[230]

Unlike the formation of a corporation or other business entity, there is no minimum capital requirement to enter into a joint venture contract.[231] Income derived under the contract is treated as earned by the venturers according to their interests and is taxed accordingly.[232] However, the Mexican managing partner

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220. Jeswald W. Salacuse, *Host Country Regulation and Promotion of Joint Ventures and Foreign Investment*, *in* INTERNATIONAL JOINT VENTURES: A PRACTICAL APPROACH TO WORKING WITH FOREIGN INVESTORS IN THE U.S. AND ABROAD 107, 128 (David N. Goldsweig & Roger H. Cummings eds., 1990).

221. *Id.*

222. The most important step in establishing a joint venture is selecting a compatible partner. JOHN P. KARALIS, INTERNATIONAL JOINT VENTURES, A PRACTICAL GUIDE 23 (1992). For information on selecting and negotiating with a joint venture partner, see *id.* at 23-39; PACIFIC RIM ADVISORY COUNCIL, *supra* note 217, at 10-12.

223. *See* PRICE WATERHOUSE, *supra* note 157, at 93 (describing the joint venture contract).

224. Barnetche & Diaz de Rivera, *supra* note 150, at 23-3.

225. The parties can be individuals, corporations, or other companies. *Id.* at 23-11.

226. Mercantile Law, *supra* note 164, art. 254. "The contract for profit-sharing must be recorded in writing, but it shall not be subject to registration." *Id.* The joint venture contract should identify the parties, specify the contributions and obligations of the parties, state the purpose of the venture, establish the duration of the contract, and identify the method for distributing profits and losses. PRICE WATERHOUSE, *supra* note 157, at 93.

227. Mercantile Law, *supra* note 164, art. 252. "A profit-sharing association is a contract whereby a person grants to others who contribute property or render services a share of the profits or losses in a mercantile enterprise or in one or more of the commercial transactions." *Id.*

228. PRICE WATERHOUSE, *supra* note 157, at 93.

229. *Id.* "The profit-sharing association has no juridical personality nor a trading name." Mercantile Law, *supra* note 164, art. 253.

230. *See* PRICE WATERHOUSE, *supra* note 157, at 93. Since foreigners are relegated to a position of minority ownership in most construction ventures in Mexico, the Mexican party will usually be the managing party of the contractual joint venture.

231. *Id.* at 94.

232. *Id.* at 93.

must pay taxes to the Mexican authorities on both its share of the income and the silent venturer's share of the income.[233] When distributing profits under a joint venture contract where the underlying activity is construction services, the U.S. party should not receive more than forty-nine percent of the profits unless the FIC grants permission.[234]

Although contractual joint ventures are used primarily for short- and medium-term business undertakings such as construction projects,[235] there are actually very few contractual joint ventures undertaken in Mexico.[236] One possible reason is that foreign investors may prefer the organizational structure afforded by a separate legal entity such as a corporation.[237]

The alternative to entering into a joint venture contract is to establish a business entity comprised of contributions of capital, services, or property from both the U.S. and Mexican parties.[238] Although it is possible to form the venture by having one party acquire a share in the other party's existing business, it is more advisable to form a new business entity to avoid any confusion about the scope and purpose of the venture.[239] Since most U.S. investors seek a legal business form that is similar to a U.S. corporation, the choice is usually between forming a limited liability company (essentially a close corporation) or a joint stock company (corporation).[240] The most common organizational form for such a joint undertaking is the corporation.[241]

A primary concern for a U.S. investor when establishing a corporate joint venture with a Mexican partner is structuring adequate mechanisms to ensure protection of minority interests in the face of legal restrictions on foreign ownership and control.[242] Although the 1993 FIL limits foreigners to minority positions in administration and control of Mexican construction companies,[243]

233. Mears, *supra* note 184, at 631.

234. PRICE WATERHOUSE, *supra* note 157, at 94. *See supra* notes 80-90 and accompanying text (discussing the 49% ownership rule).

235. Mears, *supra* note 184, at 630.

236. *Id.* at 632.

237. *Id.*

238. Barnetche & Diaz de Rivera, *supra* note 150, at 23-3.

239. Mears, *supra* note 184, at 650.

240. Salacuse, *supra* note 220, at 130.

241. PRICE WATERHOUSE, *supra* note 157, at 85. *See supra* notes 197-209 and accompanying text (discussing the benefits of incorporating and the characteristics of a Mexican corporation).

242. *See* Davis, *supra* note 82, at 2-38.

243. *Id.* at 2-19.

> With respect to the administration of the joint-venture business enterprise, Article 5 . . . of the [1973] Law on Foreign Investment, sets out that 'participation by foreign investment in the administrative bodies of the company may not exceed its participation in capital.' In the case of a corporation, this limitation refers to the representation of the shareholders on the Board of Directors when the charter contemplates two or more administrators. In this manner, the Law on Foreign Investment contemplates a connection between corporate ownership and control and requires that a certain proportionality be maintained between the two concepts.

the U.S. and Mexican shareholders can enter into agreements in the charter and bylaws to make control and administration shared functions.[244]

One way that minority shareholders can ensure some participation in the control of the corporation is to establish minimum quorums for attendance and voting at shareholder meetings.[245] Such quorum agreements effectively confer a veto power on the minority shareholders with respect to matters submitted at the general shareholder meetings.[246] As long as the veto power is limited to certain matters of fundamental interest to the foreign shareholders,[247] the exercise of control by the minority shareholders will not contravene the limitations on minority management.[248]

The foreign minority shareholders can also maintain a certain degree of control over the corporation by insisting that the minority shareholders name members to the board of directors in proportion to their stock ownership.[249] In addition, the bylaws can be drafted to provide that a quorum will not be established at directors' meetings without the presence of one member of the board of directors who was elected by the minority shareholders.[250]

Another important protection for foreign minority shareholders is the ability to negotiate the right to appoint *comisarios* or auditors.[251] Since *comisarios* supervise the business activities of the corporation, but do not have management authority themselves, it is not a violation of the 1993 FIL's requirement of majority control for the minority shareholders to elect most or all the *comisarios*.[252]

V. AVAILABILITY OF FINANCING

Although financing Mexican projects is not a legal concern for a U.S. construction or development firm, financing is an important aspect of development that merits consideration. In the words of one author, "If you are looking to invest in Mexico, be patient and bring your own financing."[253] This advice stems from the fact that long-term real estate financing is virtually nonexistent in

Id. at 2-19 to 2-20. Although the 1973 FIL was repealed, the language of the 1993 FIL carries forward the intent of the 1973 FIL in limiting foreign control. *See* 1993 FIL, *supra* note 85, ch. 3, art. 7.

244. Davis, *supra* note 82, at 2-37.

245. *Id.* at 2-22 to 2-24.

246. *Id.* at 2-37.

247. *Id. See id.* at 2-26 to 2-27 (containing an extensive list of the types of matters of fundamental interest to foreign shareholders over which shared control by foreigners and Mexicans can be exercised).

248. *Id.* at 2-37.

249. *See id.* at 2-29.

250. *Id.* at 2-30.

251. *Id.* at 2-31. *See supra* notes 203-09 and accompanying text (discussing the functions of *comisarios*).

252. Davis, *supra* note 82, at 2-32.

253. *Bay Area Firms Heading for Mexico: Top Companies Lead Rush*, *supra* note 3.

Mexico,[254] due primarily to Mexico's history of very high inflation[255] and the limited tradition of institutional investment in Mexico.[256] For example, whereas pension funds and insurance companies are traditional sources of real estate financing in the United States, Mexican pension funds and insurance companies have never focused on real estate.[257] Consequently, development projects in Mexico have historically been financed by the developer's own equity, or by a joint venture partner who will be a tenant in the building upon completion.[258]

If financing can be secured through a Mexican bank, the bank will typically arrange loans with terms of only five to seven years,[259] at interest rates that make borrowing very expensive. One Mexican developer who is on the board of directors of two banks pays a 22.5 percent annual interest rate, which he says is better than the 35 to 40 percent that other firms pay.[260]

Since Mexican developers must pay high rates of return to lenders and equity investors, a U.S. firm will have a competitive advantage if it can enter the market in Mexico with its own financing.[261] Therefore, U.S. firms who are not in a position to finance projects with their own equity should be creative in their attempts to secure funding in the United States. For example, one large U.S. developer plans to finance office buildings in Mexico by getting the building 100 percent leased with U.S. companies and then going to a U.S. pension fund for financing.[262]

Although financing construction projects in Mexico is difficult and expensive, borrowing conditions are expected to improve in the future. First, stabilization of the economy should encourage Mexican financing sources to move towards long-term financing.[263] In addition, NAFTA's opening of the financial services industry to wholly owned subsidiaries of U.S. banks[264] and the recent privatiza-

254. Pedro A. Azcue, *Multinationals Invest in Mexico City Properties . . . and Find Ways to Turn Profits as Well as Control Costs*, BUS. MEX., Mar. 1992, *available in* LEXIS, News Library, Busmex File. Whereas 90% of building projects in the United States are financed through mortgages, the figure is only 15% for projects in Mexico. Martha Trejo & Jorge Rivas, *Construction Industry Lacks Funds*, Notimex Mexican News Serv., Sept. 5, 1992, *available in* LEXIS, News Library, Notimx File.

255. *Bay Area Firms Heading for Mexico: Top Companies Lead Rush*, *supra* note 3. *See supra* note 58.

256. *Mexico Announces $16 Billion for 1994 Public Works Projects*, 11 Int'l Trade Rep. (BNA) 136 (Jan. 26, 1994).

257. *See* Azcue, *supra* note 254.

258. Kelly, *supra* note 61.

259. Azcue, *supra* note 254.

260. Schriener, *supra* note 72, at 7.

261. Azcue, *supra* note 254.

262. Kelly, *supra* note 61.

263. Damian Fraser, *Private Ambitions on Public Priorities: Mexico's Attempts to Attract Investment in Its Infrastructure*, FIN. TIMES, Aug. 25, 1993, at 12.

264. Juanita Darling, *Salinas Pushes Bill to Encourage Foreign Investment in Mexico*, L.A. TIMES, Nov. 26, 1993, at D1. *See* NAFTA, *supra* note 10, ch. 14 (pertaining to the financial services industry). U.S. mortgage companies are interested in making loans in Mexico, and are exploring possible joint ventures with Mexican banks. *Analyst Says U.S. Mortgage Companies Looking South* (CNN news broadcast, Dec. 7, 1993), *available in* LEXIS, News Library, CNN File.

tion of the Mexican banking system should lead to increased availability of development capital. Finally, the ability of developers to own land in fee in the prohibited zone under the new 1993 FIL is expected to significantly stimulate the flow of capital into Mexico from foreign lenders who were previously unwilling to lend money in the absence of a clear property title.[265]

VI. IMPACT OF NAFTA

Before the passage of NAFTA, construction industry leaders in the United States were confident that Mexico would be a viable and attractive market for construction services regardless of the trade accord.[266] However, the trade agreement does improve the prospects for U.S. firms in Mexico in two ways. First, expanded trade between the United States, Canada, and Mexico is expected to accelerate Mexico's existing plans for infrastructure improvements and also foster new infrastructure projects. Second, the substantive provisions of NAFTA should promote fair competition among the Mexican and U.S. construction companies.[267]

The cross-border trade in services chapter of NAFTA[268] prevents discriminatory restrictions against U.S. construction companies that engage in cross-border activities.[269] It requires that Mexico accord U.S. construction service providers with treatment no less favorable than Mexico accords its own construction service providers ("national treatment")[270] or than it accords other foreign construction service providers ("most-favored-nation treatment").[271]

NAFTA, however, does allow exceptions to equal treatment.[272] One exception of importance to U.S. contractors is that Mexico still limits foreign ownership of companies that engage in construction services to forty-nine percent in the absence of prior approval.[273] Fortunately, NAFTA and the 1993 FIL phase out the requirement of prior approval for majority foreign ownership on

265. Duncan II, *supra* note 85. *See supra* notes 94-97 and accompanying text (discussing the 1993 FIL as it relates to land ownership).

266. *See* Gary J. Tulacz & Debra K. Rubin, *Mexico Blooms as NAFTA Looms*, ENGINEERING NEWS-REC., Nov. 1, 1993, at 8.

267. NAFTA, *supra* note 10, art. 102(1)(b).

268. *Id.* ch. 12.

269. PAUL, HASTINGS, JANOFSKY & WALKER, NORTH AMERICAN FREE TRADE AGREEMENT SUMMARY AND ANALYSIS 60 (1993) [hereinafter PAUL].

270. *See id.* at 58. Article 1202 of NAFTA, entitled "National Treatment," states: "Each Party shall accord to service providers of another Party treatment no less favorable than that it accords, in like circumstances, to its own service providers." NAFTA, *supra* note 10, art. 1202(1).

271. *See* PAUL, *supra* note 269, at 58. Article 1203 of NAFTA, entitled "Most-Favored-Nation Treatment," states: "Each Party shall accord to service providers of another Party treatment no less favorable than it accords, in like circumstances, to service providers of any other Party or of a non-Party." NAFTA, *supra* note 10, art. 1203.

272. NAFTA, *supra* note 10, art. 1206.

273. *Id.* annex 1.

January 1, 1999.[274] At that time, a U.S. contractor will be able to establish a construction business in Mexico and own 100 percent of the company without seeking government approval. While it is quite likely that U.S. contractors will still desire the benefits of joint venturing with a Mexican partner,[275] the decision whether to joint venture will be free of direct government influence.

Although there will no longer be a requirement of approval each time majority foreign ownership is desired, approval will be required if the U.S. investor is acquiring gross assets of a Mexican company in excess of $25 million.[276]

While Mexico currently requires that foreign service providers maintain an office or presence in Mexico before licenses or certifications are issued, NAFTA promotes fair competition by phasing out this local presence requirement over the first two years of the Agreement.[277] Thus, a U.S. contractor who merely contemplates a short-term commitment to doing business in Mexico will not need to bear the expense of opening and maintaining an office in Mexico.

The NAFTA provisions that apply to investors[278] are similar to those that apply to service providers.[279] In particular, foreign investors are accorded both national treatment[280] and most-favored-nation treatment.[281] There are exceptions to the requirement of national treatment; the most important to U.S. contractors being that foreigners still cannot own land in fee for residential use in the prohibited zone.[282]

Another provision of NAFTA that is important to investors concerns a subject that has long been a source of apprehension for U.S. investors interested in

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274. *Id.*

275. *See supra* notes 216-19 and accompanying text (discussing the benefits of joint venturing).

276. NAFTA, *supra* note 10, annex 1. According to NAFTA, approval is required as follows:

> For investors and investments of investors of Canada or the United States, the applicable threshold for the review of an acquisition of a Mexican enterprise will be: (a) US$25 million, for the three-year period beginning on the date of entry into force of this Agreement; (b) US$50 million, for the three-year period beginning three years after the date of entry into force of this Agreement; (c) US$75 million, for the three-year period beginning six years after the date of entry into force of this Agreement; and (d) US$150 million, beginning nine years after the date of entry into force of this Agreement.

NAFTA, *supra* note 10, annex 1.

277. PAUL, *supra* note 269, at 60. *See* NAFTA, *supra* note 10, arts. 1210(3), (4) (licensing and certification).

278. An investment is defined very broadly, encompassing almost every property or other economic interest. *Investment Chapter Said to Solve Long-Standing U.S.-Mexico Differences*, 9 Int'l Trade Rep. (BNA) 2094 (Dec. 9, 1993). *See* NAFTA, *supra* note 10, art. 1139 (listing the activities that constitute investments).

279. *See* NAFTA, *supra* note 10, ch. 11.

280. *Id.* art. 1102. *See supra* note 270 (defining national treatment for cross-border service providers).

281. NAFTA, *supra* note 10, art. 1103. *See supra* note 271 (defining most-favored-nation treatment for cross-border service providers).

282. NAFTA, *supra* note 10, annex 1. *See supra* notes 91-100 and accompanying text (discussing the land ownership restrictions that apply to foreigners).

investing in Mexico: expropriation.[283] NAFTA should alleviate U.S. investors' fears about the possibility of the Mexican government indiscriminately taking their property. According to NAFTA, the Mexican government can only take private property in a nondiscriminatory manner and only for a public purpose.[284] Most importantly, if the Mexican government expropriates the property of a U.S. investor, it will have to pay promptly full fair market value and interest from the date of the taking.[285]

The government procurement chapter of NAFTA is valuable to U.S. construction companies who desire to bid on large construction projects for the Mexican government.[286] The chapter requires openness and competitive bidding on construction projects of federal government agencies and government-owned enterprises.[287] It specifies that Mexico must follow detailed rules when procuring construction contracts and reviewing protests from disappointed U.S. bidders.[288] However, these rules only need to be adhered to if the contracts exceed certain thresholds: $6.5 million for construction contracts of federal agencies and $8 million for construction contracts of government enterprises such as *Petreleos Mexicanos* (Pemex) and the *Comisión Federal de Electricidad* (CFE).[289] In an annex to the government procurement chapter, Mexico has reserved a certain percentage of government agency and government enterprise construction contracts exclusively for Mexican bidders.[290] For 1994, this percentage is fifty percent of the value of contracts that exceed the $6.5 million and $8 million thresholds identified above.[291] The percentage falls every other year, and the reservation is eliminated altogether in the year 2003.[292]

VII. Conclusion

Mexico has taken significant strides to stabilize its economy and position itself for a massive modernization effort and sustained economic growth. The North American Free Trade Agreement and the recently promulgated 1993 Foreign Investment Law evidence Mexico's desire to actively solicit foreign capital and technology to finance its modernization. U.S. construction and

283. *See id.* art. 1110 (the text of NAFTA pertaining to expropriation). Expropriation is defined as "[a] taking, as of privately owned property, by government under eminent domain. This term is also used in the context of a foreign government taking a U.S. industry located in the foreign country." BLACK'S LAW DICTIONARY 582 (6th ed. 1990).

284. *Investment Chapter Said to Solve Long-Standing U.S.-Mexico Differences, supra* note 278, at 2094.

285. *Id.*

286. *See* NAFTA, *supra* note 10, ch. 10 (discussing the requirements for government procurement).

287. *See* PAUL, *supra* note 269, at 40.

288. *See id.*

289. NAFTA, *supra* note 10, arts. 1001(c)(i), (ii).

290. *Id.* annex 1001.2a(1), (2).

291. *Id.*

292. *Id.* annex 1001.2a(2) (listing schedule of reduction in percentages of contracts reserved for Mexicans).

development companies who are willing to venture south of the border should encounter plenty of opportunities to participate in Mexico's development effort.[293]

Along with opportunities, U.S. firms will encounter foreign rules and regulations that must be considered and complied with. This comment has attempted to make investors and practitioners aware of some of these rules and regulations, including the forty-nine percent ownership rule,[294] restrictive land laws,[295] protective labor laws,[296] business organization laws,[297] and joint venture regulations.[298] Before a U.S. contractor pursues an investment in Mexico, it is critical to have these and other legal concerns carefully evaluated by counsel who is well versed in Mexican law.

Although many U.S. contractors and developers are hesitant to confront the unfamiliar culture and business practices in Mexico, some U.S. firms have already successfully penetrated the construction services market by forming alliances with Mexican partners.[299] After carefully assessing the market, U.S. contractors are realizing that "Mexico is a land of poor roads, faulty telephone lines, crumbling sewers and horrendous pollution—in short, a land of opportunity."[300]

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293. *See supra* notes 61-73 and accompanying text.
294. *See supra* notes 80-90 and accompanying text.
295. *See supra* notes 91-132 and accompanying text.
296. *See supra* notes 133-63 and accompanying text.
297. *See supra* notes 164-213 and accompanying text.
298. *See supra* notes 214-52 and accompanying text.
299. Susan Christian, *Fluor Joins Forces with Mexican Firm; Construction: Irvine Engineers and ICA Industrial Seek to Benefit from an Expected Boom South of the Border*, L.A. TIMES, May 19, 1993, at D1. Among the firms that have teamed up with Mexican partners are Bechtel Corporation and Fluor Daniel. *Id.*
300. Freadhoff, *supra* note 73.