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Doing Business In... 2021

Mexico: Trends & Developments

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Trends and Developments

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2021 started with a surge of COVID-19 infections. The health crisis was carried over from 2020 but the surge was a direct result of the December holiday period, during which people – weary after several months of enforced social distancing and lockdowns – gathered to celebrate the end of a difficult year. Shortly thereafter, advancements in vaccinations across the world signalled a partial return to normal life. As the pandemic entered its second year, people were starting to see light at the end of the tunnel.

In Mexico, government-implemented restrictions on public gatherings, public space reopenings and business reopenings were subject to a “traffic light signal” system, whereby, as infection and hospitalisation levels decrease, restrictions are gradually lifted. By mid-May, several states were in the yellow (least serious) phase of the pandemic, but a full reopening of the economy had not yet been achieved.

The Mexican economy is still reeling from the effects of the pandemic, which impacted several of the economy’s core industries, such as tourism and entertainment. More recently, the decision by the Federal Aviation Administration to downgrade Mexico’s aviation safety rating is expected to negatively impact the tourism and aviation sectors’ recovery and prevent additional expansion, possibly even affecting the operations of the new airport being built near Mexico City.

However, certain sectors, such as healthcare and e-commerce, have seen their business thrive. Meanwhile, others, such as real estate, are making a comeback.

This year will also bring what are probably the most important mid-term elections in the country’s recent history. At stake are the renewal of the House of Representatives, as well as elections for the governor of 15 states, among numerous other state and local elected offices. The country’s political parties have essentially separated into two different blocks – one aligned with the government and ideology of President Andrés Manuel López Obrador, and the other seeking to prevent the governing party from obtaining the majority of the House of Representatives and looking to act as a counterweight to the current government. The outcome of the elections will dictate the course for the remainder of this administration, which ends in 2024.

Reform of Employee Subcontracting Regime and Profit-Sharing

Introduction

In an unprecedented effort not seen in decades, the Mexican government pushed through a series of reforms aimed at ending two harmful practices that had been used for many years in connection with the work force: (i) abusive outsourcing mechanisms used to avoid labour obligations and to artificially reduce the payment of social security contributions and employment income taxes; and (ii) limitation of profit-sharing that has to be paid to employees. The reforms exceeded their reach in many cases – affecting not only the intended harmful practices but also lawful employee outsourcing and insourcing structures – and will certainly change the way in which business in Mexico is conducted, going forward.

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The reforms, which included amendments to the federal Labour Law, the Income Tax and Value Added Tax laws, the Federal Tax Code and the Social Security Law, were approved by Congress and published in the Official Gazette on 23 April 2021.

The entry into force of the amendments is gradual, until all the related rules for the application of the new legal provisions are issued, and certain terms elapse. Its main effects can be summarised as follows: (i) labour and social security law amendments entered into force on 24 April 2021; (ii) amendments to the tax-related provisions will become effective on 1 August 2021.

Summary of the main labour and tax ramifications of the reform

Subcontracting personnel is prohibited, with subcontracting of personnel being understood as a provision of services in which an entity or individual provides or makes available to another entity its own employees for the other entity's benefit.

Contracting specialised services will be permitted only if such services or tasks are not part of the corporate purpose or main economic activity of the contracting party, and only if the contracted party is listed in a public registry of specialised service providers. Rules for the registration process were issued by the labour authorities on 24 May 2021.

Complementary or shared services or tasks provided between companies of the same corporate group will also be considered as specialised, as long as they are not considered within the corporate purpose or the main economic activity of the company that receives such services or tasks.

Individuals or entities providing personnel outsourcing services will be required to complete a registration process before the Labour Min-

istry and to renew such registration every three years. To be registered, individuals or entities must prove they have complied with all their tax and social security obligations.

A joint and several liability is recognised between the individual or entity who engages the specialised services or specialised works and the contractor who fails to comply with the obligations resulting from the relationships with its workers.

As a legal requirement for an employer substitution to occur, the assets of the company or establishment are to be transferred to the substitute employer. However, individuals or companies that operate under a subcontracting regime will have 90 days (until 24 July 2021) to transfer its employees to the beneficiary company without need of transferring assets to the substitute employer as long as the latter recognises the employment conditions of employees, including seniority.

The amount of profit-sharing to be paid to employees will be capped to three months of salary or the average amount received by the employee in the last three years, the applicable amount being whichever is more favourable to the employees. The rest of the rules to compute and distribute profit-sharing to employees are not affected.

Substantial economic sanctions could result for employers who benefit from personnel subcontracting arrangements in violation of the new provisions of the Mexican Labour Law.

For tax purposes, tax invoices issued for disallowed subcontracting of personnel will not have legal effects (ie, non-deductible expense for income tax purposes and inability to claim a value added tax credit on such expense).

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The use of simulated schemes of provision of specialised services or the execution of specialised works, as well as the subcontracting of personnel, will be considered a criminal tax offence.

Conclusion

The reform described above will change the way companies do business in Mexico in future, and it has caused an impressive investment of thousands of labour hours on the part of companies, businesses, lawyers, tax and labour advisors, labour authorities, employer and entrepreneurial associations, among others, to adapt, restructure and otherwise modify operating structures to become compliant with the new rules on time. A lot of work is still needed to finalise all the necessary restructuring, but decisive steps to implement the most urgent parts of the reform are under way. As with any new standard of operation, it is certain that the work for legal professionals will continue strongly in the months to come, until all – or at least, most – of the effects of the reform are felt and tested.

Mexican Energy Sector/Antitrust

Introduction

Starting in 2019, the new Mexican federal administration has attempted to implement significant changes in the energy sector, seeking to override the new market configuration that was established during the previous federal administration. In 2013–14, the energy sector was structurally reformed with an almost full opening to private investment.

Changes were initially sought through administrative decrees issued in 2019 and 2020 by the Ministry of Energy (SENER), the sector's regulator, the Energy Regulatory Commission (CRE), and the independent system operator, the National Center for Energy Control (CENACE). The main goal has been to strengthen the state-owned utility CFE and the state-owned oil company PEMEX and to displace private investment.

Specifically, the federal administration issued regulation to the effect that (i) CFE's power plants would be dispatched preferentially, and (ii) CFE's supply division could bring on more legacy GenCos, and for a larger period of time, into its legacy supply contract, while cancelling long-term and medium-term auctions (which were the preferred method for the purchase of power by CFE's supply division).

For context, prior to the energy reforms of 2013, CFE was a fully integrated monopoly tasked with the generation and supply of electricity. Following such structural amendment, CFE was unbundled vertically, in generation, transmission, distribution, commercialisation and supply units, and horizontally in its generation segment, creating several generation divisions based on the legal regime that would apply to each power plant, with the aim of fostering competition in the market. In addition, rules were enacted so that while CFE's supply division could continue to purchase electricity from the several CFE legacy GenCos to ensure supply (through a legacy supply contract), on the one hand, new medium-term and long-term contracts would have to be obtained through auctions (where only renewables could be awarded long-term contracts for the sale of electricity), and, on the other, legacy GenCos would have to be gradually phased out from the supply pool.

It is also worth noting that the implementing regulations of the energy reforms established an "energy dispatch" based on economic efficiency and merit. In this system, the more economically efficient power plants, considering their variable costs, would be dispatched first. This led to clean energy being preferred over fossil fuel-based generation, as the variable costs of the former are next to zero compared to the high cost of fuels borne by conventional sources. Economic dispatch also ensured that market prices were the lowest possible, since

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the market pricing configuration was based on price nodes determined by the power plant to be dispatched last in such hub (marginal facility).

As for the hydrocarbons sector, PEMEX was the exclusive player in the exploration and production (E&P) sector. It dominated first-hand fuel sales, allowing private investment to participate only through franchise agreements, and controlled the national pipelines system, although the development of natural gas transportation systems by private parties was allowed. Post-reform, public tenders were launched for oil firms to take part in upstream activities, and midstream and downstream was completely opened up through a permit regime, where all applicants who fulfilled the required legal conditions are allowed to carry out transportation, storage, processing, distribution and commercialisation of hydrocarbons. For purposes of the foregoing, asymmetric regulation was imposed by CRE upon PEMEX in all areas.

Similarly to energy auctions, public tenders for E&P activities were called off by the current federal administration. Likewise, SENER tried to amend existing regulations in matters of import and export of hydrocarbons, so as to eliminate the possibility of obtaining long-term permits (with a 20-year validity).

In addition to the foregoing regulatory changes, CRE has generally delayed the issuance and amending of permits well beyond the applicable statutory deadlines and, to the extent possible, required sponsors to submit additional documents and information, above and beyond the requirements of law.

SENER, CRE and CENACE have remained practically closed to the public since the early days of the COVID-19 outbreak (CRE only opening up for a couple of months by the end of 2020). These shutdowns have prevented or delayed fil-

ings in matters of social impact assessment, permit applications and interconnection requests, impeding the development of new projects or the continuance of existing projects, which were already facing other COVID-19-related delays in construction and supply.

Recent developments

Early in 2021, the President and his political party introduced bills to Congress to amend the main laws of the energy sector. These bills were passed by Congress without much debate.

In the electricity sector, the amendment to the Power Industry Law formally provided that CENACE would dispatch CFE's generation fleet first, especially if contracted by CFE's supply unit. In addition, it provided that CRE should follow SENER's directive in the granting of permits and that CENACE should limit open access to the grid.

On the other hand, the amendments to the Hydrocarbons Law introduced wider powers for CRE to revoke permits related to downstream activities and, for reasons of "national interest", even take over service stations and hand control over to PEMEX, while imposing harsher requirements for new players to obtain permits and enter the market. Furthermore, such amendments led to the annulment of all asymmetric regulation that had been imposed on PEMEX resulting from the energy reforms, with the goal of presenting a level playing field for other competitors to enter the hydrocarbons market.

So far these legal reforms have been halted by federal courts specialised in economic competition, following a flood of amparo lawsuits (constitutional reviews) brought by the private sector to defend their acquired rights, free competition and environmental rights, through permanent injunctions that will remain in force until the merits of the case are ultimately resolved.

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These amparo proceedings are supplemented by other constitutional remedies brought before Mexico's Supreme Court of Justice by state governments, the Mexican Economic Competition Commission (COFEC) and even congressional minorities.

In most proceedings, plaintiffs have successfully argued that the amendments deter competition because they impose entry barriers to new participants and give an undue advantage to the dominant agents, CFE and PEMEX.

Implications in matters of climate change

In addition to hindering competition in the market to the detriment of end-users, the federal administration's policy in the sector has compromised Mexico's goals and international obligations in matters of climate change.

Mexico is the 12th-largest GHG-emitter. In its Intended Nationally Determined Contribution under the Paris Agreement, Mexico committed to an unconditional reduction of 22% in its GHG emissions by 2030. This would require reaching peak emissions by 2026. The ultimate goal, also considering the cut of short-lived climate pollutants and conditional commitments, was achieving a 50% cut in the volume of emissions by 2050 in reference to a year 2000 baseline.

For purposes of the foregoing, the INDC commitments were embedded into Mexico's domestic law. The 22% overall reduction of GHG emissions would require a decrease of emissions of, among others, 31% in the energy generation sector, of 14% in oil and gas, as well as of 18% in transportation, of 18% in the residential and commercial sectors, of 5% in the industrial sector, and of 8% in agriculture. To achieve these goals, aiming at low carbon-oriented policies in power generation and hydrocarbons industries, which provide the former sectors with basic inputs, is essential.

Particularly in the electricity industry, the General Climate Change Law and the Energy Transition Law set a goal for minimum participation of clean energies in the energy matrix, consisting of 25% for 2018, 30% for 2021 and 35% for 2024.

As a result of the current administration's energy policy, it is unlikely that Mexico will achieve its clean energy goals. SENER's 'Report on advances of clean energies 2018 to 2020' states that, by mid-2018, clean energies contributed to 22.2% of the energy matrix, and such figure increased to only 25.5% of the total generation by October 2020.

Specifically, in an analysis of the current status of clean energy credits in Mexico's electricity industry, COFEC projected two scenarios: (i) "scenario A", assuming that all clean energy projects that are considered in official plans are actually executed (ie, the expected scenario), and (ii) "scenario B", considering the available data of installed capacity and commercial operation dates for 2018–19, with a 2020–24 projection considering the feasibility of certain projects (ie, the realistic scenario). In the expected scenario, clean energy generation would contribute 33.6% in 2024. However, in the realistic scenario, the percentage would be 29.8%, resulting in a gap of over 5% with respect to the 35% goal. It must be noted that this analysis was published before the publication of the amendment to the Electricity Industry Law and did not consider the impacts of renewables being dispatched after CFE's facilities.

The federal government's questionable focus on fossil fuels and the revival of CFE and PEMEX will most likely result in price increases in electricity and fuels in the short term, which will be paid directly by end-users or indirectly through subsidies, and even international arbitration claims, which would adversely complicate the economic environment in Mexico. However, of greater con-

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cerns are the effects (including through a larger burden in the GDP) that derailing the contribution of clean energies and low-carbon goals in the path to combat climate change will have.

Antitrust in Digital Markets

COFECE and the Federal Telecommunications Institute (IFETEL) have increasingly become interested in digital markets and the technology markets related to them.

COFECE has had several interviews with players in digital and technology markets in order to obtain a better understanding of these markets and determine how to approach them. Additionally, COFECE has been carefully scrutinising merger control procedures (concentrations) in these markets and conducted an investigation of a possible abuse of dominance (relative monopolistic practices) in the e-commerce and related markets, which was then closed.

As a result of the above, as well as recent international developments in these markets and Mexican federal court decisions regarding disputes between COFECE and IFETEL, in which both agencies claimed to have authority to deal with digital markets, COFECE published its 'Strategy in Digital Markets'. According to this strategy, the digitalisation of the economy requires action specifically aimed at addressing the challenges posed by the digital economy and the operation of the markets which participate in it. For the digital economy, COFECE understands the exchange of numerous products and services by consumers and suppliers in various markets, taking advantage of and exploiting the telecommunications infrastructure and information technology industries' products (software and hardware) as inputs that allow generating new forms of carrying out this exchange.

COFECE is particularly concerned about market performance, including significant levels of

concentration in digital markets, anticompetitive practices by large global technology players, the increasing accumulation of data and the increasing digital divide. COFECE has, therefore, increased its analytical and investigation capabilities, taking the following steps:

- preparing a document with public policy suggestions for digital markets to benefit Mexican consumers;
- effectively enforcing Mexico's Federal Economic Competition Law;
- actively enhancing the prevention and correction of anticompetitive market structures;
- strengthening its capabilities and technological infrastructure;
- creating a new office in charge of supervising digital markets; and
- strengthening international co-operation.

In view of the above, it is expected that COFECE will be very active in the digital and technology markets in the near future. Particularly, it is reasonable to expect that COFECE will first try to address the following concerns:

- the winner-takes-all approach;
- the acquisition of potential future competitors;
- the abuse of market power through price discrimination, predatory pricing, refusal to deal, tying, and most favourable nation clauses;
- the use of consumer bias;
- zero-pricing;
- use of algorithms as a new means of collusion;
- the abuse of consumer data.

Moreover, on 24 August 2020, the Investigative Authority of COFECE published in Mexico's federal Official Gazette an abstract of the beginning of an ex officio investigation on the possible existence of abuse of dominance (relative monopolistic practices) in the digital advertising and related services market. The investigation

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is being conducted under file number IO-003-2020.

Initially, the investigation will identify whether there are anticompetitive tying and/or packaging, specifically the sale conditioned to buy, acquire, sell or provide another product or service, different or distinguishable from another product or on the basis of reciprocity, as well as any other form of displacement, specifically the action of one or several economic agents aimed to increase costs, hinder the productive process or reduce the demand faced by other economic agent.

Additionally, through the new Digital Markets Office and the Markets Intelligence Office, COFECE will likely start gathering information from public sources and, through the Concentrations Office, it will use concentration proceedings to obtain additional information on the markets in which they are interested.

Finally, IFETEL published the beginning of an investigation for barriers to entry and essential facilities in online searching services, social media, mobile operating services, cloud services, and related services, to which COFECE filed a court procedure claiming that IFETEL does not have authority to investigate this market. The resolution of this dispute is pending at the time of writing this article. However, it is expected that new disputes on this issue will still arise during the next years until courts clearly rule on the authority of each agency.

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Mijares, Angoitia, Cortés y Fuentes, S.C. was established in Mexico City in 1994 by a team of highly qualified lawyers focused on offering professional, sophisticated and quality legal services to satisfy its clients' business needs. Today, as a leading firm in the Mexican market, its level of expertise is well recognised in many practice areas and its lawyers have been recognised by the most prestigious publications worldwide. Deeply committed to quality and responsiveness, the firm has consolidated

its status as one of the pre-eminent Mexican full-service law firms. As the firm has gradually grown, it has attracted professionals with significant experience in the public, industrial and financial sectors, creating a team with the highest level of professional experience. Most of its lawyers and other professionals have completed graduate studies at foreign universities and have worked at law firms abroad, thereby giving them a better perspective on international legal systems.

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Nora Morales is a partner at Mijares, Angoitia, Cortés y Fuentes. She has more than 20 years of experience in controversy and tax litigation focused on transfer prices,

benefits in the application of international treaties and the energy sector. Nora has been a legal tax adviser to companies in various sectors, including energy, automotive and consumer products. Previously, she was partner in different local and international firms, such as EY Mexico and Chevez, Ruiz, Zamarripa. In addition, Nora actively participates in various chambers and associations, such as the Fiscal Commission of the Business Coordinating Council (CCE), the Precedents and Legislation Committees and the BEPS Initiatives Committee of the International Fiscal Association (IFA).

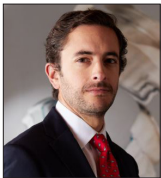
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strong bonds with the various antitrust authorities, judges, lawyers, and economists, as well as with experts in regulated sectors in the region. Carlos has advised companies in Mexico in landmark competition/antitrust matters on behalf of national and international clients regarding merger control procedures, as well as in defending companies facing investigations on monopolistic practices. Among his exclusive tools, he has developed a high-end technology system to address companies' competition/antitrust needs and is the founder of MootComp, a non-profit international organisation engaged in the debate of competition/antitrust issues.



Ignacio Armida is a partner at Mijares, Angoitia, Cortés y Fuentes. He has experience in general corporate law, M&A and financings. Ignacio has advised buyers, sellers and investors in

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Claudio Jiménez is a partner at Mijares, Angoitia, Cortés y Fuentes. He has broad experience advising national and foreign, public and private companies in various sectors. In

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Aisha Calderón joined Mijares, Angoitia, Cortés y Fuentes in 2010, starting as a law student, and has been an associate since 2014. She works in the energy area, with a focus on renewable

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