ETCHEGARAY
ABOGADOS

Re: Analysis of Different Options for Business Operations in Mexico

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This Memorandum serves the purpose of giving to our clients and friends, a general and preliminary analysis of the different forms of establishing presence to do business in Mexico through a subsidiary, as well as the steps for forming and start operating a Mexican subsidiary and the information required for such purposes. We have also included a brief explanation on the need to grant powers of attorney, the scope of the authorities that may be granted and the common ways to limit such powers of attorney.

I. CORPORATION (SOCIEDAD ANÓNIMA) VS. LIMITED LIABILITY COMPANY (SOCIEDAD DE RESPONSABILIDAD LIMITADA)

The most common options to establish a business in Mexico are opening a branch office or incorporating a Mexican company, in particular (a) a "Sociedad de Responsabilidad Limitada" (similar to the German GmbH or a Limited Partnership) and (b) a "Sociedad Anónima" (similar to the German "Aktiengesellschaft" or a "Corporation"). Another option to start business activities in Mexico is to acquire an existing Mexican company. The first decision to be made is to choose between any of these two.

Although we find basic differences between the SRL and the SA (as described below), it is our legal experience that both kinds of companies are managed and operated in a substantially similar manner when they are wholly-owned or controlled by one company.

The main differences between an SRL and an SA are the following:

- **Tax Treatment.** Mexican law does not grant any different tax treatment to these companies. However, we understand (although we are not U.S. tax attorneys) that based on U.S. tax legislation, foreign subsidiaries not considered as "corporations per se", may elect to be treated as limited companies or "partnerships" for tax purposes. This alternative gives such companies certain tax benefits in the United States, especially during the first years of operation where, generally, they experience losses. Therefore, the SRL (not considered as "per se corporations") has become an investment vehicle option for U.S. companies that desire to engage in operations in Mexico. Consequently, SRL's are being used more frequently. However, if the holding company will be a Belgian company, this different tax treatment may be irrelevant in the case at hand.

- **Equity investors' liability.** With respect to the limits on equity investors' liability, there is no difference between these companies since both on the SA and the SRL, equity investors (called shareholders in the case of the SA and partners in the case o f the SRL) are only liable to pay the price of their respective equity, and therefore, in no event (except in case of fraud and in limited cases related to tax, antitrust or labor matters), would the equity investors be liable for the operations of the company.

- **Management.** Both the SA and the SRL are managed in a very similar manner in a two or more-tier structure where the Shareholders' or Partners' Meeting is at the top and the management body (called a board of directors in the case of the SA and a board of managers in the case of the SRL) comes next. These bodies have the same functions and authority in both companies. Additionally, the SA must have a statutory auditor. Naming a statutory auditor is optional in an SRL. Particularities regarding the management and operation of these companies attend more to the nature of the business and to the controls negotiated among the shareholders or partners than to specific rules provided for by the General Law of Commercial Companies (Ley General de Sociedades Mercantiles) ("LGSM") to each kind of company. However, if the shareholders or partners fail to provide specific management rules, the LGSM has a more detailed set of default rules for the management of an SA.

- **Minority rights.** The statutory rights granted to minority investors in an SA are more than those granted to minority investors in the SRL. For instance, in an SA, shareholders' representing 33% or more of the capital stock may challenge and suspend the adoption of any resolution. Likewise, shareholders have a statutory right to postpone a shareholders' meeting whenever they consider themselves insufficiently informed of the matters to be discussed. These statutory minority rights are not significant in the case at hand since the newly formed entity will be wholly-owned, directly or indirectly, by Mobile Financial Services Holding, sprl.

- **Separation rights if management is conferred to a non-partner individual.** Any partner in the SRL has a statutory right to separate himself from the company whenever management is conferred to a person that is not a partner or whenever management is delegated to a non-partner. In practice, this statutory right is difficult to enforce since it is not clear how the equity quotas should be redeemed by the company and at what value. The shareholders of an SA are not granted with separation rights in this instance.

- **Ousting a partner.** A partner of an SRL may be ousted for limited reasons provided by the LGSM such as using the company for its own business, infringing the by-laws or applicable law, frauds against the company or insolvency. There are no statutory rights to oust a shareholder.

- **Evidencing equity participation.** Evidencing participation as an equity investor is also different in these companies. The distinction relies in the fact that the SA issues stock, which is considered to be a negotiable instrument that may be transferred to simple endorsement. Under these circumstances in order to participate as a shareholder, a simple endorsement of the stock certificate is sufficient. That is not the case in the SRL because evidence of participation as a partner does not reside in a stock certificate, but rather in equity quotas that are not necessarily represented by documents. Equity quotas may be documented in a written instrument, but are not considered negotiable instruments and therefore cannot be transferred through simple endorsement. Each partner has the right to own only one equity quota and each quota may have a different value (except when the equity quotas grant different rights to their holders). However, please note that in both companies participation as a shareholder or partner needs to be evidenced through appropriate entries in the corporate books.

- **Transfer of equity.** With respect to transfer of the equity holder status (sale of stock or equity quotas) the nature of each company bears a significant difference between them. In the case of the SRL the acceptance of new shareholders requires a special quorum (vote of the majority of the equity participation unless the by-laws require a higher percentage); in contrast to the SA, where the general rule is free transmission of stock. Nevertheless, it is common for SA's by-laws to include clauses that limit the free transmission of stock.

- **Number of equity investors.** With respect to the number of shareholders or partners, there is a difference between the SA and the SRL, because the SA may have an unlimited number of shareholders while the SRL may have a maximum of fifty partners. Therefore, the SRL is prevented both to offer its equity quotas to the public (i.e., listing in stock exchanges) as an alternative source of financing its operations and to be formed through public subscription. There are, however, mechanisms to list in stock exchanges certificates issued by trusts that are linked to the equity of an SRL.

- **Non-par value equity.** An SRL cannot issue non-par value equity quotas whereas an SA may issue non-par value stock.

- **Capital calls, spin-offs, mergers.** With respect capital calls, capital redemptions, transformation, spin-off, merger and capital contributions both in kind and in cash, the same principles are applicable to both companies, with the exception that in the SRL the by-laws may require additional contributions from its partners. In both cases negative controls and special provisions for the taking of decisions may be provided for in the by-laws.

II. STEPS TO FORM AND START OPERATIONS OF A MEXICAN SUBSIDIARY AND INFORMATION REQUIRED FOR SUCH PURPOSES

Summary. A Mexican subsidiary may be formed within the two weeks after we receive the appropriate powers of attorney to form the entity and all information needed for such purposes. The most relevant steps for forming a Mexican subsidiary are: i) granting members of our firm a power of attorney to form the entity, which will need to be notarized and apostilled in the United States; ii) obtaining a name permit; and iii) drafting, notarizing and registering the by-laws with the Public Registry of Commerce. Immediately after formation, the newly-formed entity needs to obtain a tax identification and an importer registry, in addition to other notices and filings with governmental offices. The company shall also open bank accounts and print invoices to begin operating. It is very important for the company to retain an accountant (either as an employee or as an independent services provider) who may help the entity with its tax accounting from the outset.

A. Steps for formation:

- **Name permit.** Obtain name permit from the Ministry of Foreign Affairs (Secretaría de Relaciones Exteriores). If the desired name is available, this process should take around two Business days.

- **Power of attorney for formation.** Each of the partners shall grant members of our firm with a special power of attorney to form the entity on their behalf. This power of attorney must be granted following the formalities of the Protocol on the Uniform Legal Regime of Powers of Attorney of 1940. A draft that meets these formalities will be prepared by us and sent for your review and for you to fill-in the blanks. This power of attorney needs to be notarized and apostilled in the United States. This process usually takes around one week.

- **Draft the by-laws.** Since the newly-formed entity will be a wholly-owned subsidiary of Mobile Financial Services Holding sprl, the by-laws will be a very straight-forward document that mirrors the provisions of the LGSM. This process usually takes around two business days and it may be done simultaneously with the granting of the powers of attorney for formation.

- **Notarization of the by-laws.** Once the power of attorney for formation is received, the by-laws shall be notarized. This process usually takes around two business days.

- **Registration of the by-laws.** The by-laws and formation deed shall be filed for registration with the Public Registry of Commerce. Although completion of registration takes a lot of time (usually a couple of months), the company may begin operations after the by-laws have been filed with the Public Registry of Commerce. A letter from the notary public stating that the by-laws have been filed with the Public Registry of Commerce is usually enough to evidence such filing.

B. Information required for formation:

- Desired form (SA or SRL)

- Desired corporate name

- Brief description of the corporate purpose - in light of the activities to be undertaken;

- Amount of capital – there is no minimum.

- Names, nationality, address of at least two equity holders- one member may have all equity contributions and a second one making a nominal one;

- Names, nationality and address of the members of the Board of Directors or Managers - Managers designated in the new company may be non-Mexicans, but care should be given to the fact that they may not legally come to Mexico to hold a meeting unless they have the proper business visa issued by Mexican immigration authorities;

- Alternate Managers, if any;

- Statutory auditor (mandatory in case of an SA or optional in case of am SRL);

- Officers of the company; and

- Persons who will be granted powers of attorney and the scope of their authorities (see section III below); powers of attorney may be granted to non-Mexicans, but care should be given to the fact that they may not legally exercise such powers in the Mexican territory unless they have the proper business visa issued by Mexican immigration authorities.

C. Post-formation items:

- Retain accountant (either as an employee or as an independent services provider) for tax accounting assistance at startup phase and for governmental notices and filings.

- Lease office space to have as a tax address.

- Register the company with the Federal Taxpayers' Registry of the Tax Administration Service (Servicio de Aministración Tributaria) for purposes of obtaining a tax identification number commonly referred to as RFC.

- Register the company with the Importers' Registry for customs clearance purposes in the case of export/import operations.

- Obtain electronic signature for tax purposes from the Tax Administration Services and print invoices.

- Obtain immigration visas for non-Mexican managers or persons vested with powers of attorney.

- Open bank account(s) with local banks.

- Ensure that a zoning permit exist for the establishment of the premises of the company.

- Secure registration with the corresponding Chamber of Commerce and the SIEM (Sistema de Información Empresarial Mexicano), as required by Mexican law.

- Secure registration with the National Registry of Foreign Investments (Registro Nacional de Inversiones Extranjeras).

- Register the company with the Statistics, Geography and Information National Institute commonly referred to as the INEGI.

- Prepare initial transcriptions for the Partners' Registry Book and Capital Variations Book.

III. POWERS OF ATTORNEY

Summary. Unlike in the United States, no officer or manager in Mexico is authorized to act in the name and on behalf of the company by reason of its mere appointment as an officer or manager. To act on behalf of a Mexican company, any person needs to be granted with powers of attorney. There are four general authorities that may be granted to individuals in Mexico in order for them to act on behalf of a company: i) lawsuits and collections, which basically authorizes the person to appear in judicial proceedings and sue third-parties on behalf of the company; ii) acts of administration, which basically authorizes the person to execute transactions in the ordinary course of business; iii) acts of ownership, which basically authorizes the person to sell and encumber assets; and iv) financial transactions and negotiable instruments, which basically authorizes the person to execute banking and financial transactions on behalf of the company. These authorities may be restricted or limited (e.g. joint signatures, amount limits) and the authority to delegate them may also be granted.

- **No implied authorities.** First of all, we must start by saying that as opposed to what happens in other jurisdictions, officers of a Mexican company cannot perform their duties without a power of attorney. In other words, our corporate rules do not recognize the doctrine of implied or apparent authority that would give a person the ability to act on behalf of a company by the mere fact that that person is an officer or a director of a Mexican Company.

- **Specific resolution to grant powers of attorney.** Therefore, officers or any person that needs to act on behalf of a Mexican company must be given the proper authority by way of a power-of-attorney issued by the company through resolutions adopted by its Partners' Meeting or Board of Managers' Meeting (according to the specific rules included in the company's by-laws).

- **Types of authority.** The specific type of authority that may be vested through a power-of-attorney is as follows:

  - Lawsuits and Collections: required to appear before any type of party and/or government agency in order to process claims, applications and other formal requests whether in a litigious or other context.

  - Acts of Administration: authority required to perform transactions in the ordinary course of business of the company.

  - Ownership Acts: authority required to transfer title to fixed assets of the company (except for assets transferred in the ordinary course of business of the company).

  - Negotiable Instruments and Financial Transactions: authority required to open and close bank accounts, sign against those accounts, issue notes and other similar transactions.

  - Substitution Authority: authority to be able to delegate the powers of attorney in favor of other persons by the initially authorized individual.

- **General or special powers of attorney.** In all cases referred to above the powers may be granted in a general format (usable in an undetermined number of acts) or special (usable only for a determined and limited number of acts).

- **Limited general powers of attorney.** Likewise, the powers may be given with or without limitations, same that may include any type of restrictions on monetary amounts, joint signatures, or other forms or requirements decided by the company upon granting the respective powers of attorney. Finally, in some cases the powers of attorney are granted with some additional language that is customary in special type of legal areas, for example, for participation in public bidding procedures or in labor litigation cases.

- **How to decide on what authorities should be vested on an individual.**
  The decision of what type of authority should be granted to each individual is the result of a careful analysis of what that person needs to perform his/her responsibilities efficiently. Some general rules that should be kept in mind are the following:

  - Powers of attorney for ownership acts are seldom if ever given because nobody should be able to sell the fixed assets of the company. When needed this power of attorney should be issued only on a specific basis to authorize the sale of a specific asset.

  - Powers of attorney for lawsuits and collections that are issued in favor of lawyers that are going to handle only one case and that are not responsible for other matters should be granted as special powers of attorney to prevent those lawyers from participating in other matters without the company's consent and/or awareness.

  - Powers of attorney for negotiable instruments and negotiable instruments are usually restricted as per a limited amount or joint signature to avoid the risk of having unlimited capabilities in the hand of one single person and the problems associated with an abuse by that individual.

  - Authority to delegate powers of attorney is also sensitive because if it is granted without any limitation, that person may grant as many powers of attorney as desired without any type of corporate control with the problems associated with that practice. Therefore, this authority should be restricted to individuals who must have this possibility to grant not only full powers of attorney but even proxy-letters for simple procedures. In all cases either using the services of the corporate secretary or advising the latter of any instruments granted would appear to be a healthy rule for corporate practice and updating the records of the company.

- **Failure to grant powers of attorney turns to the company into an inoperative company.**
  Based on the above, we need to emphasize the fact that if the local officers for a local company are not granted powers of attorney they would simply not be able to conduct business for the company. Ever since its formation, the company must have local officers and representatives who hold the necessary powers of attorney to do business for the company.
  Therefore, it would be completely inappropriate to not issue powers of attorney because that would effectively result in the company not being able to perform any of its business activities. However, the company must be very sensitive to the issue of who has powers of attorney and likewise the type of authority granted to make sure that there are no persons who may have more authority than that strictly required to perform their activities and responsibilities.

IV. POWERS OF ATTORNEY

- Employers dealing with operations in Mexico should be aware that labour relations are highly regulated in our country and that Mexican employees generally have greater rights than in other jurisdictions. According to Article 123 of the Federal Constitution, the Federal Labour Law (hereinafter the "FLL") protects every employee within Mexico, regardless of the nationality of the employer or employee, the place of execution of the labour agreement or payment of salary. Once an employment relationship exists, all the rights and obligations under the FLL automatically apply, regardless of how the agreement is characterized by the parties.

- Written employment agreements in Mexico are mandatory. Every employee must enter into an individual employment agreement with the employer and set out the terms and conditions of the employment. There is no 'employment-at- will' in Mexico. An employer must have justified cause (as defined by the FLL) in order to terminate the employment relationship, if not, employer must compensate the unjustly terminated employee accordingly (FLL stipulates the amount for severance payments). Notwithstanding the previous statement; in the given case that an employment relationship exists and there is no written agreement; the employee's constitutional and statutory rights are not waived or affected by this omission.

- The Mexican FLL, assumes, as a general principle, that an employment agreement has been executed for an indefinite term, unless the nature or the particular type of service to be provided calls for an employment agreement for a specific job or term, or if the parties agree to execute an employment agreement for initial training or subject to a probationary period.

- Employment agreements executed for an indefinite term or for a specific job or term of more than 180 days, may be subject to a probationary period of 30 days, or up to 180 days for executive positions, in order to verify that the employee has the necessary knowledge and skills to perform the services for which he has been hired.

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If you have any doubt regarding the contents of this letter or wish any additional information, do not hesitate to contact us. We at Etchegaray Abogados shall be pleased to oblige.

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