

HOW TO STRUCTURE YOUR SALES TO MEXICO SO AS TO MINIMISE RISK

By
GUILLERMO MARRERO

Guillermo Marrero is the partner at International Practice Group in San Diego. The firm specializes in U.S.-Mexico legal matters. The author would like to thank Sophie-Andree Dube, a Canadian attorney specializing in International Law, and Dr. Leonel Pereznieta-Castro, a licensed Mexican attorney for their helpful contribution to this article. For more information please visit us at www.ipglaw.com

HOW TO STRUCTURE YOUR SALES TO MEXICO SO AS TO MINIMIZE RISK

INTRODUCTION

When choosing to engage in trade with Mexico, foreigners benefit from a vast selection of selling methods. The method one chooses will depend on the degree of involvement it desires to have with Mexico. The various ways to sell products to Mexico can be divided in two categories: doing business "with Mexico" or doing Business "in Mexico". The former category suggests engaging in international trade directly from the home office while the later goes a step further by establishing a presence such has a representative office, branch office or franchise or also by entering into a partnership venture or establishing a Mexican corporation.

Doing business "in Mexico" is a more complex and costly venture which comprises a great amount of economic risks for the foreign company. To avoid exposing itself to those risks, a foreign company may sell products to Mexico from abroad, without establishing a physical presence there. The prime advantage of doing so is to avoid, or at least minimize, involvement with the Mexican tax system and also to avoid incorporation or licensing requirements and other areas of regulation such as Mexican labor laws, social security, etc.

To sell goods to the Mexican market, without establishing a presence in Mexico or engaging in direct sales to Mexico, a foreign manufacturer or seller might prefer doing business with an independent distributor who will bear alone the risks of sale, service and payment. The foreigner will sell its goods to the Mexican

distributor who will resell them directly to the Mexican market. The independent foreign distributor buys the United States product for its own account and resells it through its own network at a profit. The distributor, operating its own business, takes title and accepts the goods at its own risk.

Contrary to a sales agent, the distributor is not an employee of the foreign company. His income will not come from a paycheck but from the difference in price it pays the selling company and the prices it charges its customers for the goods. Because of this independence from the foreign company the distributor will therefore not be subjected to Mexican labor laws.

1. DISTRIBUTORSHIP AGREEMENTS

A. APPLICABLE LAWS

(i) Commercial Code and Civil Code

The general rights and duties of a distributor's contract are governed by the Mexican Commercial Code and the Civil Code. One must be aware of the requirements of both branches of Mexican law, for the rules of the Civil Code supplement the substantive provisions of the Commercial legislation. Mexican law requires a variety of more formal devices that must be respected by the foreign vendor.

The knowledge and respect of the Mexican norms enclosed in these Codes will help foreign sellers in protecting their rights. There is no special protection for distributors under Mexican law. The relationship between the distributor and the

foreign vendor is simply subject to the Mexican Civil law principal of contractual freedom.

(ii) Mexico's Foreign Trade Law

Mexico's Foreign Trade Law prohibits unfair trade practices such as price discrimination and price subsidies on imported products to Mexico. Items imported to Mexico under price discrimination or a price subsidy basis will be subject to the imposition of countervailing duties.

(iii) Patents and Trademark Law

Mexico's Patents and Trademark Law enacted in June of 1991 (Ley de Fomento y Protección de la Propiedad Industrial) protects the confidentiality of the industrial property rights and other information conferred on a distributor.

Trademark and patent applications made abroad are recognized by Mexico as long as they are made within the terms of international treaties or within the previous 6 months, in case of trademarks, or 12 months in case of patents, from the day the application is filled in Mexico. (art.40 & 117)

(iv) Federal Economic Competition Law

The new Federal Economic Competition law, enacted in December 1992, is the first legal regime for protecting and promoting full and open competition in Mexico. This law is of important concern when dealing with a Mexican distributor

who already benefits from a monopoly on its part of Mexico or in the Mexican market as a whole.

This law protects competition by preventing and eliminating monopolies, monopolistic practices and other restrictions on free movement of goods and services in the market place.

Two categories of conduct are prohibited by the law: absolute monopolistic practices and relative monopolistic practices.

Absolute monopolistic practices are similar per se to offenses under United States Antitrust Law. They include: fixing prices, limiting production and dividing markets.

The relative monopolistic practices require an approach like the rule-of-reason standard applied to similar practices prohibited by U.S. law. They include acts and agreements whose purposes or effects may be to allow unfair competition by granting:

- exclusive distributorship
- impose price and other improper conditions in sales contracts
- requiring tied-in sales
- limiting purchase from 3rd parties

and any other act that wrongfully injures or impedes competition.

B. DRAFTING DISTRIBUTION AND SALES AGREEMENTS

When drafting distribution and sales agreements all important terms of the contractual relationship must be spelled out to avoid applications of different

usages of trade when interpreting the agreement. This clarity and precision in drafting distributor's documents, for use in international transactions, will permit subsequent disputes to be resolved within the wording of the agreement and therefore avoid **needless legal ramifications.**

In defining the terms of the contract it is, foremost, important to make clear what relationship will exist between the foreign company and the Mexican distributor as to not confuse its functions with an "employee" or "agent" relationship which would be subject to labor laws of Mexico. **The agreement must clearly reflect the distributor's independence.** As a matter of protection it would be wise to include a "no employment relation" clause in the distributor's agreement.

An international distributors agreement contains the same basic clauses as found in international sales agreements:

- warranty requirements
- maximum or minimum price discounts, and other terms of trade
- mutually acceptable dispute settlement
- precise terms on amount and timing of payments for goods
- **specific circumstances of renewal/expiration/termination**
- incorporation of INCOTERMS: deal principally with the apportionment of risk of loss of goods in transit, passage of title to the goods and the costs of transportation, custom duties and insurance.
- risk of loss: "force majeure" clause
- protection of exporter's intellectual property rights

In addition to the former issues enclosed in sale's agreement, a distributor's agreement should also specifically address the following issues :

- specific goods and/or services covered
- guidelines on prices, delivery and transfer of title
- territory to be covered,(geographical limitations)
- length of the association, and other issues.
- **freedom of distributor to determine the prices and other sale policies**
- **minimum number of sales to be made within the territory**
- subdistributors allowed or not
- termination consequences: (1) unfilled orders upon termination
(2) settling accounts between distributors and exporters upon termination
(3) instructions regarding the return or disposition of promotional sales and other literature relating to the exporter's products in the distributor's possession at termination

2. CREDIT TO MEXICAN DISTRIBUTORS

When the buyer/distributor is unable to pay in cash and has no credit, or when a seller is promoting its goods, the vendor might want to grant the distributor with an open account. Prior to doing so, the vendor should obtain a background research on the distributor's financial history.

A. INFORMATION SOURCES TO CONSULT ABOUT MEXICAN DISTRIBUTORS

(i) Mexican Registro Federal de Contrubientes

This document permits us to investigate the standing of the proposed debtor, i.e., whether or not the taxpayer has satisfied all current obligations.

(ii) Corporate Client (Acta Constitutiva)

The corporate charter information provides basic corporate information including copies of the bylaws, designated agents and other background corporate information.

(iii) Bank References

This document seeks information regarding the reputation of the proposed debtor. Although this may be difficult to obtain Mexican bank-related information, the debtor's willingness to provide banking references may be relevant as an indicator of credit worthiness.

(iv) Financial Statements

In Mexico, corporations are required to prepare annual audited financial statements. Accordingly, you should request a copy of the debtor's financial statements for the previous year.

B. CREDIT AGREEMENT

A frequent business error when providing Mexican distributors with credit over foreign merchandise consists of documenting the corresponding credit sales on standard U.S forms. Such a practice is self defeating and normally leads to prolonged and needless litigation. Instead one should draft the loan documentation with Mexican enforceability in mind to assure the greatest degree of collection success. Respecting the Mexican legal scheme in collection matters will provide a foreigner with additional protection in dealing with commercial credit transactions in Mexico.

The credit agreement should contain clauses pertaining to the following:

- proper acknowledgement of debt
- nature of credit
- dates and places for payment
- jurisdiction

C. MEXICAN PROMISSORY NOTES (PAGARE)

The Mexican pagare is closely analogous to the promissory note used in transactions in the United States. A pagare does not provide a synopsis of the actual sale, but is, rather, a simple statement of debt containing the following information:

- (1) A statement to the effect that it is a promissory note;
- (2) An unconditional promise to pay a given sum of money;
- (3) The name of the person to whom the payment is to be made;
- (4) The time and place of payment;

(5) The date and the place where the document is signed; and

(6) The signature of the signer or the person who signs at his request or in his name *.

* (This person's authority to sign must be evidenced by a power of attorney or corporate resolution naming the signor an agent of the principal.)

ENFORCEMENT OF A PAGARE

The enforcement of a pagare follows rules similar to the enforcement of promissory notes in the United States. The holder of a Mexican pagare has a right to sue the maker of the note to enforce the payment of the note.

"Summary or Executory" proceedings are the preferred method of enforcement of pagares. Transactions allowing for summary proceedings are preferred for a couple of reasons. First, a judgement may be obtained within a relatively short period of time. A summary proceeding on a collection matter, for example, may take one year, while ordinary proceedings for collections often take two years or more. Second, while the pre-judgement of attachment of a defendant's assets to assure execution is a commonly used strategy on an ordinary proceeding (compared to a summary proceeding), if the debt instrument contains the appropriate wording, the creditor has the right to an automatic pre-attachment lien over the debtor's assets.

When considering the enforceability of debts, however, one must bear in mind a distinction between the availability of an enforceable remedy and the

practicality of seeking enforcement. As in any collection action in the United States, the utility of a promissory note is only as good as the assets, and viability of the defendant. Unsecured credit subjects the foreign seller to risks of collection. The pagare sets forth the amount and the terms of the debt, thereby allowing the use of summary proceedings and taking these issues theoretically out of dispute, when the debt is a non-secured obligation, the note is only as valid as your ability to enforce it. Accordingly, the use of the pagare goes hand-in-hand with the credibility and viability of the debtor.

A pagare secured by a property interest is the most effective means to assure its enforcement. The Mexican Commercial Code provides a summary attachment procedure which the payee can use to seize and sell property belonging to the maker or any guarantors in order to satisfy the pagare.

In order to commence the summary procedure, the following documents are required by Mexican counsel:

- (1) the original pagare with the protest duly noted on the pagare
- (2) a duly executed and legalized power of attorney.
- (3) a copy of the entire credit file, specifically an itemization of all property of the debtor which can be seized.

3. PRACTICAL ISSUES

A. OFFICIAL NOTARIAL POWERS OF ATTORNEY

Because Mexican law is more formalistic, the United States vendor must be aware of the specific requirements when dealing in commercial credit transactions.

One of the most important formalities in Mexican Law requires the attorney to be specifically granted authority through a formal agreement. The power of attorney is never assumed in Mexican law, therefore if the party signing the credit application does not have the express powers of attorney to represent the debtor, then only the executing party can be pursued for payment of debt. This issue often represents a trap for the unwary who learn their lesson only after failing to collect against the individual/companies they thought were debtors only to learn that the party signing did not have an authority to bind the company.

The power of attorney must therefore be issued by the grantor in favor of the Mexican attorney who will be handling the case. The power can be restricted to limit the authority granted to representation of the grantor in the collection of the debt. The power must be signed before a notary public by a duly authorized agent for the grantor, and then the signature of the notary must be authenticated or "legalized" before a Mexican consular official.

B. CURRENCY RISKS

To minimize currency risks, specify in the documents that the payment be made in pesos at the rate of exchange in effect as of the date that the transaction is consummated, provided that the exchange rate is contained in the instrument.

CONCLUSION

Given the numerous opportunities springing up on a daily basis south of the border, it is now crucial that foreign businesspersons consider the many complex and unfamiliar laws and customs that will greet them as they move into the Mexican market. While these laws and customs may seem strange at first, they are not unmanageable. With the proper information and attitude, a foreign seller can comfortably and successfully do business with Mexico.