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Comments on a Mexican Due Diligence Process.

by Jaime A. Treviño.

Legal and business due diligence activities are part of the day-to-day tasks of any corporate legal practice, and especially in areas such as public financing transactions and mergers and acquisitions. In a simplistic manner, I can define a due diligence process as the series of actions and analysis performed with the purpose of learning and understanding the real situation prevailing in a business as of a relevant point in time and keeping in mind a specific purpose or goal.

There are different types of due diligence procedures, such as the financial, real estate, intellectual property, import and export, corporate, and of course the "overall" or general due diligence, commonly used for mergers and acquisition transactions.

For the purposes of this article, we will attempt to mention only some of the basic areas which should be reviewed within an overall due diligence process for a Mexican business operation.

The generalities of a common due diligence process and its elements have been assumed as known facts and are not covered in this article. There are a great number of good manuals and books describing the main aspects to be covered as part of a due diligence process. The purpose of this article is to generally address some of the particularities involved in these type of proceedings in Mexico, such as:

Financial and Tax Matters. Only very recently did the financial information of most Mexican businesses start to be recorded in accordance with international Financial Information Norms, or FINs, and some mid-size and large Mexican companies continue keeping their records under U.S. or other countries' GAAP. For past years, still most Mexican companies reported under Mexican GAAP. The differences in these reporting rules result in the absolute need of the qualified advice of a team which is familiar with their differences in order to appropriately analyze the financial information. On the other hand, Mexican tax law is extremely complex and the Mexican revenue service, as most all others worldwide, is at times very aggressive in attempting to collect taxes through a number of means. A full analysis of the business' tax situation is mandatory before any merger or acquisition transaction is formalized.

Real Estate Ownership. Mexican law limits the real estate ownership rights over certain regions of its territory, know as the "restricted zone" to Mexican national only. Additionally, ownership of real estate by foreigners or Mexican legal entities with foreigners "admission" clause requires compliance with periodic reports to the Mexican Secretary of Interior. Ensuring proper compliance with these regulations is important before taking control, or participating in the capital, of a business entity.

Labor Matters. Labor matters are especially relevant in Mexico. Although in mostly any due diligence process in any country of the world labor matters are a part of the process, generally they are not a determining factor of the transaction. In Mexico, labor matters are a critical part of any negotiation and in certain cases become one of the main reasons for the business acquisition transaction itself. While some experts indicate that the Mexican labor unions' force is becoming less radical every day, there still exist some labor unions and workers' groups which are conflictive and result extremely costly in the day-to-day operation of a business, generating substantial costs and risks to Mexican businesses. The strategic management of labor matters in Mexico, including labor union's relations, goes beyond the word of the law and legal technique and, in my opinion, is truly the result of a combination of technique, awareness, intelligence, experience and some "artwork". In addition to critical labor union matters, labor risks upon the acquisition of a Mexican business may result to be financially material. It is important to briefly mention that one of the particularities of the Mexican employment relationship is the right that every worker has to receive compensation for unjustified work termination and which, among other factors, is determined based on the seniority of each worker, measured as the number of years during which each relevant worker has been employed by the particular employer. As Mexican labor law provides for very limited causes for justified labor termination, and those available are normally difficult to prove in court, these severance and termination compensation amounts may add-up to material amounts even in small business. Therefore, the risks involved should never be minimized.

Especially in due diligence procedures, and in subsequent merger or acquisition transactions, relying on the professional advice of expert legal counsel is a determining factor for the success of a business venture.

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