

THE FOURTH MEXICAN TRANSFORMATION

Mexico is undergoing significant political change with the election of left-winger, Andrés Manuel López Obrador ("AMLO"), as President. AMLO took office on December 1 and has committed to bring about the 'fourth Mexican transformation' (the first three were the independence in 1810, the reformation in 1855 and the revolution in 1910), which he says will induce change "as profound" as the one brought by the revolution but without violence.

AMLO, who won a landslide victory, has promised to focus on ending the "cancer of corruption and the *mafia del poder* (power mafia)" that he says is rife in Mexico. He plans to implement a number of ambitious infrastructure initiatives including building railways and trains, renovating Mexico's water infrastructure, building at least two refineries and modernizing Pemex (Mexico's oil company) and CFE (Mexico's power utility).

Mexico is the 14th largest economy in the world and Latin America's second largest economy after Brazil, accounting for more than one-fifth of the region's GDP. Despite the decrease in oil prices, the depreciation of the Mexican Peso over the last year, the increase in interest rates and the heightened political tension with the US, Mexico's economic condition and foreign direct investment have remained stable. Among emerging markets and MINT¹ economies, Mexico has been one of the main recipients of foreign direct investment, boosted by 11 structural reforms (energy, labor, antitrust, telecom, tax, financial, education, criminal, *amparo*, political and transparency) which were designed to a great extent during the Calderon administration (2006-2012) and passed in 2013 by the Peña Nieto administration.

AMLO is expected to benefit from a number of factors, including:

- the recent discovery of the Ixachi-1 oil field and, potentially, a continuing increase in oil prices;

¹ Mexico, Indonesia, Nigeria and Turkey.

- the ratification by the US Congress of the trade agreement (USMCA) reached by the US, Mexico and Canada to replace the North American Free Trade Agreement, which could be delayed due to the Democratic House majority;
- the fact that most of the structural reforms described above are now being successfully implemented;
- the majority that AMLO's party ("MORENA") has in Congress and the number of states and municipalities controlled by MORENA;
- the perception of Mexico's financial markets as more robust and sophisticated; and
- the anticorruption policies which are being put in place.

Energy and Infrastructure

The previous Mexican administration headed by Peña Nieto completed approximately 73% of the infrastructure programs provided under its National Infrastructure Plan (2014-2018). These programs included strategic projects in the telecom, energy, health and tourism sectors. Electricity reform, which was of particular interest to international investors, has been successfully implemented with more than 90 contracts awarded to 44 companies from 12 countries (China, Mexico, Italy, France, US, Spain, Canada, India, Denmark, the UK, Japan and the Netherlands).

Mexico's transition team has broadly set out 35 fundamental policies for the AMLO administration in the National Plan 2018-2024. These policies, which include new commercial agreements with China, seek to make Mexico more equitable and more competitive. This focus on commercial agreements with China seems timely, as China continues to pursue its Belt and Road Initiative, seeking to build a new silk road-style trade corridor and increasing Chinese investment in infrastructure and other projects across 65 countries worldwide. AMLO's ambitious infrastructure initiative could provide attractive opportunities for Chinese investment in a variety of sectors.

In terms of energy and infrastructure, the new administration has announced the following projects:

- the development of 300 rural roads in the states of Oaxaca and Guerrero;
- the Isthmus of Tehuantepec corridor project (together with the expansion of the Salina Cruz (Oaxaca) and Coatzacoalcos (Veracruz) ports), which aims to compete with the Panama Canal and connect Asian countries with the East Coast of the US;
- the Mayan Train, to boost tourism in the Mayan Peninsula;
- the construction of two oil refineries and the modernization of four existing refineries;
- the modernization of the Benito Juarez, Toluca and Santa Lucia airports, instead of the construction of the Texcoco airport;

- the construction of 13 hydroelectric plants; and
- the construction of two 700MW coal-fired power plants.

In addition, it is expected that the new administration will continue to expand and modernize the national grid as provided under the National Electric System Development Program (PRODESEN), which contemplates a US\$12 billion investment in the National Transmission Network from 2017 to 2031.

Mexico's ability to successfully implement its ambitious infrastructure agenda will depend on the new administration's ability to work with the private sector and the Mexican development banks (such as Nafin, Bancomext, Banobras and Nadbank). The new administration will need to design standard bankable models that can easily be financed through traditional project finance structures or capital market solutions, to take advantage of Mexico's lending liquidity and the multiple structured instruments, such as the CerPIs (*certificados de proyectos de inversión*), CKDs (*certificados de capital de desarrollo*) and the Fibras E, that have been tested by international players and the AFOREs (*Administradoras de Fondos para el Retiro*).

Project development often tends to be reactive rather than well planned, prioritized and efficiently executed. As seen in other Latin American jurisdictions, such as Colombia (with the 4G toll road program) and Argentina (with a similar P3 program), in Mexico, public- and private-sector participants must work together from the start, promote knowledge sharing and invest more in predevelopment stages if their ambitious plans are to be successful.

Dealing with Corruption

Latin America remains embroiled in a series of major corruption scandals such as the Brazilian Lava Jato investigation. Beginning in 2014, Lava Jato became the largest corruption scandal in the history of Latin America, involving 11 countries beyond Brazil and resulting in the imprisonment of former President Luiz Inácio Lula de Silva and the indictment and impeachment of former President Dilma Rouseff.

Argentina is also embroiled in a burgeoning corruption scandal. A number of prominent Argentine businessmen and public officials have been charged with paying more than US\$200 million in bribes for public contracts. The related investigation began with the discovery of notebooks of a former driver of the former administration which described bags with millions of dollars in cash paid to government officials. The "Notebook Scandal" is already one of the largest corruption scandals in the history of Argentina.

It is against this regional backdrop and taking into account certain corruption scandals that surrounded the Peña Nieto administration, that AMLO campaigned against corruption, decrying it as the "evil" causing the "social and economic inequality" and "violence in Mexico." Given that AMLO was elected with the highest percentage of the popular vote by any presidential candidate since 1994 and that MORENA has majority in Congress, he appears to have a mandate and the political power to fulfill his anti-corruption campaign pledges.

The question is whether an impending Mexican anti-corruption purge will spawn the same type of economic upheaval Brazil experienced as a result of the Lava

Jato investigation. Previous administrations have promised to fight corruption with limited results. If the AMLO administration or the new independent anti-corruption prosecutor decide to start investigations, they will have to carefully manage targeted investigations to mitigate the prospect of broader economic instability.

CONTACTS

Americas

Joshua Berman
Partner

T +1 202 912 5174
E joshua.berman
@cliffordchance.com

Glen Donath
Partner

T +1 202 912 5138
E glen.donath
@cliffordchance.com

Thais Garcia
Partner

T +1 212 878 8497
E thais.garcia
@cliffordchance.com

Megan Gordon
Partner

T +1 202 912 5021
E megan.gordon
@cliffordchance.com

Fabricio Longhin
Partner

T +1 202 912 5015
E fabricio.longhin
@cliffordchance.com

Jonathan Zonis
Partner

T +1 212 878 3250
E jonathan.zonis
@cliffordchance.com

José García Cueto
Special Legal
Consultant

T +1 202 912 5123
E jose.garciacueto
@cliffordchance.com

Alan Sakar Azuara
Special Legal
Consultant

T +1 202 912 5435
E alan.sakar
@cliffordchance.com

Edwin Ramirez-Homs
Law Clerk

T +1 212 878 8118
E edwin.ramirezhoms
@cliffordchance.com

London

Deborah Zandstra
Partner

T +44 207006 8234
E deborah.zandstra
@cliffordchance.com

Spain

José Guardo
Partner

T +34 91 590 7595
E jose.guardo
@cliffordchance.com

Beijing

Jiahua Ni
Partner

T +86 21 2320 7206
E jiahua.ni
@cliffordchance.com

Mariana Estévez
Associate

T +1 212 878 8251
E mariana.estevez
@cliffordchance.com

Decheng Zhang
Associate

T +86 10 6535 4933
E decheng.zhang
@cliffordchance.com

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www.cliffordchance.com

Clifford Chance, 2001 K Street NW,
Washington, DC 20006-1001, USA

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