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Mexico: The New Investment Frontier

*The Editor interviews **Dino E. Barajas**, Partner in Akin Gump Strauss Hauer & Feld LLP's Global Project Finance and Corporate Practice Groups.*

Editor: Please describe your practice area as well as geographic area in which you concentrate.

Barajas: My area of focus from a practice perspective is project financing, project development and mergers & acquisitions. My work entails assisting developers in negotiating each part of an infrastructure project – the land agreements, the construction contracts, in the case of a power plant, the power purchase agreements, fuel supply agreements for natural gas or coal projects, and operation and maintenance agreements. The development of infrastructure projects is diverse, ranging from power to water to transportation.

In terms of geographic reach, I mainly focus on the U.S., Latin America and the Caribbean, which I have been doing for 20 years. I have spent about 40 percent of my time in the U.S. with 60 percent distributed among Mexico, Brazil, Colombia and Chile and the countries of Central America. I've worked throughout the Caribbean, including Trinidad, Curaçao, St. Maarten and the Dominican Republic. Aside from the development work, which takes me to any point where the client has an interest, I've also represented private equity investors who have provided capital for the development of these infrastructure projects. I have also represented lenders in their project financings or acquisition financings as well as some of the contractors that are doing the construction work or the equipment supply work on these projects.

Editor: You have been instrumental in closing a number of project finance deals in Mexico and elsewhere in Latin America. Please describe what procedures one follows in determining that the assets are substantial enough to throw off the cash flow to support the deal.

Dino E. Barajas

Barajas: We try to assist the developer in its initial assessment of the risk profile of the specific jurisdiction where the infrastructure project is being built, including an analysis of the political risk, the regulatory risk, the ability to avail oneself of the judicial system for dispute resolution, the enforceability of claims and, more importantly, the credit quality both of the jurisdiction and, more specifically, of the counterparty that will provide the revenue source for the project. In cases where the markets have attracted international investment over a long period of time, there have been a number of first-of-their-kind projects that have kick-started interest in some of the markets, a good example being those in Mexico. Mexico has been extremely successful in attracting private investment to its power sector. Two first-of-their-kind deals, where I was involved, were Enertek, a self-supply power project between a private developer and corporate offtaker, and Merida III, a power project where CFE (*Comisión Federal de Electricidad),* the national electric utility for Mexico, became the power purchaser. These initial projects inspired interest on the part of the private sector and, in the case of Merida III, also on the part of the lending community. They became the template for future projects for both the private and the lending sectors.

Power projects have proliferated throughout Mexico, allowing the country to leverage its own investment capital into other areas of infrastructure, such as transmission build-out, where it would be more difficult to attract private investment. Mexico has taken the example of a successful power sector and used it as a model to promote development in other sectors, such as the water sector, e.g., aqueducts and water treatment facilities, the transportation sector, involving the build-out of toll roads, and other types of improvements allowing for the monetizing of project revenue streams in order to support the private sector investment into these types of projects.

Editor: The concept of public/private partnerships applied in Mexico finds favor in many countries.

Barajas: There have been different models utilized by different governments. In some cases, governments may establish a purely private investment regime for putting out requests for proposals for the delivery of certain commodities, such as additional electric power. In other cases where it may not be desirable to simply leave it up to the private sector to decide on how to structure the model for the delivery of a public service, the blending of a public/private partnership may be the answer. These projects require some level of government involvement in the management or oversight of the quality parameters of the infrastructure asset in question.

Editor: Does the Mexican government lend any support to project financings that support infrastructure?

Barajas: Yes and no. In the case of Mexico, the strength of the national economy, the fiscal policies that have been maintained by various administrations over the last 20 years, the credit rating of its sovereign debt – these factors in and of themselves attract private capital without the need for government guarantees. The fact that CFE has the payment obligation backstopping its projects is sufficient to attract private investors to the market.

The strength of the economies of such countries as Mexico, Chile, Trinidad, et al., will attract foreign investment for govern-

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ment projects without any credit enhancements. Other jurisdictions may have a more difficult time in attracting capital because the specific agency or operating entity does not have the strong balance sheet to support all the payment obligations. In these cases, some form of financing engineering is necessary.

Editor: How does your representation of a bank as trustee differ from your representation of the project promoter?

Barajas: For each type of representation, whether you are representing a developer, a lender, a contractor or a trustee or other service provider, you have to approach all engagements with the overall analysis of a project to make sure that, at the end of the day, the project makes sense for everyone. You don't want to end up in a situation where there is a mismatch in terms of risks and rewards because, at some point in time, someone may be induced to walk away from his or her obligations, and the entire deal falls apart. If I am representing a developer, I need to negotiate all the project agreements with the endgame in mind: the successful financing of the project. Although I am negotiating certain provisions to provide the best protection for my client, at the same time I am incorporating into the documentation knowledge of the requirements to be imposed by the other parties who will come into the transaction at a later stage. My goal is to avoid any potential delays in financing that would result from the reopening of project agreements at a later date in order to restructure a risk/reward balance required by the financial community.

If I'm representing a lender, I also try to keep my developer hat on under my lender hat simply because I need to understand the specific attributes of the jurisdiction that I am dealing in. The market in the U.S. is extremely different from the market in Mexico or Chile. If you don't appreciate the nuances of the specific market that you're dealing with, you are going to end up speaking past your counterparty because not only do you have a language barrier *literally* but you have, in some cases, a language barrier *symbolically* in that you do not understand how their market actually works. If you don't have that sensibility, you're going to end up dragging out negotiations, thus ending up hurting your client.

As a lawyer, your task is to add value to the transaction, develop a creative solution that benefits other parties at the table but does not cost your client, and, at the end of the day, the relationship between the counterparties is not simply to get the project done, but to live with the project over its lifetime.

Editor: You have also been actively involved as counsel in a number of projects involving wind farms and solar projects. Please describe the credit support needed to secure financing. Has the Mexican government taken any measures to support the wind farm industry?

Barajas: The latest development of power projects in Mexico is renewable energy. The Mexican government's success in attracting non-recourse financing to fossil fuel-fired projects has now been applied to the development of wind projects, solar projects and, to a lesser extent, geothermal projects and hydro projects. The government has undertaken the promotion of energy development from renewable energy sources. One example is its provision for "postage stamp wheeling." This means that a developer pays the same price to move an electron from one part of the country, theoretically, to another part of the country as it would pay were it to move an electron next door. The benefit to the overall market is to incentivize an effective use of resources. While Mexico's wind resources may be in a certain location – Oaxaca, Tamaulipas or Baja California (three regions within Mexico) – your potential customers may be in another area where there may be 100 different delivery points. By promoting the efficient use of the wind or solar resource, you are now allowing developers to site their solar or wind project at the most efficient and cost-effective location.

As long as you supply the entire grid with an electron, whether produced by green energy or fossil fuels, it's going to be utilized at some point within the grid. While the end user is blind to the source of energy, from a policy perspective, green energy development has been promoted in an effective way without having to utilize tax incentives. Market-based policies such as these are likely to be sustainable for many years, regardless of the changes in fiscal policies.

Editor: With Mexico's rapid economic growth, do you think the effort for greater power generation will keep up with its energy requirements?

Barajas: It will, and the reason is that there has been so much success over the last 20 years in attracting to the market private equity investors as well as international power plant developers. The Mexican energy market continues to offer attractive returns for investors and developers. Additionally, the size of the market also is attractive for new market entrants because numerous opportunities are available simultaneously in various parts of the country with a wide variety of potential offtakers ranging from large corporate partners to governmental entities.

Editor: President Nieto has expressed interest in unshackling Pemex, the national oil company, from some of its rules against foreign investment. What are your thoughts about opening up more areas for hydrocarbon development and modernization of Pemex's facilities?

Barajas: I think the hydrocarbon market in Mexico is one of the most attractive in all of Latin America. Under the Mexican Constitution, the exploration and exploitation of hydrocarbons is reserved to the State, but Pemex has been unable to realize the full potential of the country's resources. Ever since the nationalization of the oil companies during the 1930s, there have been strong nationalistic feelings in Mexico about the country controlling its own oil and gas resources. To optimize the value of these resources, new technology needs to come into the market from the private sector. President Nieto is developing a long-term vision of policies he plans to carry out during his six-year term, one of which is to address ways in which to enhance hydrocarbon recovery without infringing on the Constitution. He sees the need for providing for private sector opportunities and, at the same time, honoring historical principles that need to be respected, while still providing for the maximum benefit to the populace in terms of where he wishes to take the country in the next six years.

Editor: The *Financial Times* has recently published an article about the "Aztec tiger" implying that Mexico with its nearly 4 percent growth rate is likely to outdistance Brazil as an economic wonder. Do you think this is accurate?

Barajas: Looking at opportunities throughout the Americas, both Mexico and Brazil are going to be key target markets for international investors looking to diversify their infrastructure portfolio. Mexico is clearly the "Aztec tiger" with an economy that has shown steady growth on sound fiscal policies. The fact that it has been able to maintain its high credit rating despite a worldwide economic slowdown is a testament to where Mexico is going to be in the future.