Reform of the telecommunications and broadcasting sectors in Mexico

Preliminary Analysis

13 March 2013
If transatlantic mergers are in vogue in the northern hemisphere's legal markets, then Hogan Lovells is one of those proving that despite the challenges, the concept can go very well indeed. The new firm is now one of the small group of truly international firms – such as, on these pages, White & Case, Clifford Chance, Baker & McKenzie, and a few more – who really have significant clout on the global stage. Thus even though UK firm Lovells did not have a significant presence in the region, the overall Latin America practice is more significant than Hogan & Hartson's had been on its own; with much greater strength in Europe and Asia giving the merged firm a critical mass in a range of areas. Latin America is also obviously important to the firm; it is in the process of opening in Rio, with a very senior partner, Claudette Christian, at the office's head, a clear sign of its ambition. Its Caracas office, to the untrained eye an anomaly in the region, is in fact a real boon, with some major financing and arbitration work as a result; the Miami-based Miguel Zaldivar has been central to this. José Valdivia, with long experience and an excellent name in the region, co-chairs the Latin American practice from Miami alongside Bruno Ciuffetelli in Caracas, underlining the relevance of Venezuela to the group's strategy. Rumours abound that Hogan Lovells is planning on expanding with an office in Mexico; it says options are being considered but no decisions have been taken. In terms of service offer, the Latin American team's existing strength in energy, project finance and infrastructure is now matched by finance and insurance capabilities, and the firm has achieved greater visibility in arbitration too.

**PROJECT FINANCE & INFRASTRUCTURE**

Project finance has long been a strength for this firm in the region, largely thanks to Miguel Zaldivar, co-head of Hogan Lovells' project and public finance practice and a key member of the Latin American practice in Miami. A large deal for him in 2012 showed the merged team working at its best; he and partners in Paris advised Ecuador in gaining significant financing from French banks to develop a metro line and a tram line in the country. Zaldivar, a Venezuelan, has been targeting work from China in this sector with demonstrable success, with work for the Export-Import Bank of China and the China Development Bank. José Valdivia is also prominent in project finance work, often working alongside the Caracas office in advising PDVSA; in August they helped the company sign US$3 billion in EPC contracts with construction companies and land US$1 billion worth of financing to expand the Puerto la Cruz refinery. Claudette Christian works mostly on Brazilian infrastructure matters; she is based in Washington, D.C., but will relocate to Rio once the firm has approval for its office there. In Houston, two partners are prominent in this area; Jose Luis Vittor and David Locascio.

**ENERGY**

The firm is core external counsel for PDVSA, and leverages that to gain excellent experience in challenging markets. In 2012 that expertise in Caracas was taken up a notch with the hire of Diogenes Bermudez, formerly GC for Petrobras in the country.

**CAPITAL MARKETS**

PDVSA has kept the firm busy in capital markets work too, with José Valdivia assisting in a bond issuance worth US$3 billion. Emil Arca is a very highly regarded structured finance lawyer based in New York; in 2012 he advised the underwriters of a bond issue by Panama's state-owned toll road company, and helped Guatemala's Banco Industrial issue bonds worth US$500 million – the largest ever placement by a private sector issuer in Central America. Russell DaSilva is also active in New York.

**CORPORATE AND M&A**

José Valdivia is a key member of this team, as is Jose Luis Vittor; in 2012 he helped Luxembourg based Millicom International Cellular acquire Cablevisión Paraguay, in the country's largest ever telecommunications deal. Other corporate partners include New York based Maria Luisa Canovas, admitted in the U.S. and Spain, who recently helped a consortium of Peruvian home appliance retail chain, Tiendas Efe, and private equity funds belonging to Linzor Capital Partners, Grupo Wiese and PQ Investments, acquire rival Total Artefactos. Graciela Llaneza in Madrid is also prominent. A team from many offices helped Canadian investment fund Brookfield team up with Spain's Abertis to buy a stake in the Brazilian unit of Spain's OHL.
The stakes of the game

Mexico has announced a major reform in the telecommunications and broadcasting sectors, liberalizing not only foreign investment, but also promising antitrust enforcement and government infrastructure sharing, along with targeted sector-specific regulatory reform. These changes, when implemented, will provide significant opportunities for international investors to enter and/or increase their positions in the Mexican telecommunications and broadcasting sectors.

This summary presents a preliminary analysis of the 11 March 2013 constitutional amendment initiative presented jointly by the President of Mexico (Executive Branch) and a recently formed political coalition of the three major political parties in Mexico, called “Pacto por México.”

As a cautionary matter, please note that the amendment presented is still in discussion and for its approval it will require the vote of at least two-thirds of the members of the Mexican Congress (Legislative Branch) in each of its chambers, as well as 51% of the State Legislatures of Mexico. Afterwards, the proposed reforms will have to be harmonized with several existing laws and regulations at the Constitutional level in Mexico.

We believe that these reforms might consolidate in a process over the third and fourth quarters of the year, and will continue to be implemented through the rest of the current administration.
The reform in detail

Below is a summary of the main points of action that we believe will be the center of this new telecom reform in Mexico.

1. Digital inclusion and social gap

   • The reform has a strong emphasis on creating a new constitutional right for Mexican citizens to access technologies and broadband. This is a right strongly endorsed in the presidential campaign of the current administration.

   • By means of the reform, the Mexican State would commit to foster policies to combat the digital gap and to provide distant communities with telecommunication services.

   • This policy intends to expand business opportunities for companies providing innovative next-generation wireless services, Internet access and satellite communications. These services will expand the Mexican communications infrastructure, and in turn will be supported by the new policies and investment opportunities.

2. New foreign investment rules

   • Foreign investment will be significantly liberalized in the telecom and satellite communication sector, which is proposed to be allowed to support up to 100% of direct and controlling foreign investment.

   • In the broadcasting sector, non-Mexican entities will be able to achieve a 49% investment position through regular voting shares, while the current limits are 0% of foreign investment in this field.

   • The bill, as proposed, would allow that these new limits to foreign investment would become effective on the date on which the constitutional amendment is passed later this year, even prior to the actual conforming amendments to the Foreign Investment, Telecom and Broadcasting Laws.

3. New elements in the telecom regulation

   • The current Federal Telecommunications Commission (COFETEL) would be replaced by a new and theoretically reinforced Federal Telecommunications Institute (IFETEL) in charge of regulating the sector and issuing telecom and broadcasting licenses.

   • A unified set of regulations for telecom licenses, permits and authorizations would be created.

   • Telecom operators would be able to render a variety of services through their networks, instead of separate per-service limitations currently in use.

   • IFETEL will be granted specific authorities to regulate the telecom sector, including the sale of assets of incumbent operators, as well as to establish asymmetric obligations and the cross-ownership of telecom and broadcasting infrastructure. Substantive market power for antitrust analysis purposes would start at 50% of market participation. The authorities of the Federal Antitrust Commission of Mexico will also be reinforced.
• Special courts for broadcasting, telecommunications, and antitrust litigation will be created and the right of appeal of decisions taken by IFETEL would be limited. These new courts would be required to be created 60 days after the new reform is passed.

• Local loop unbundling obligations, access to the local loop of incumbent telephone, television, and Internet operators would be implemented within 180 days following the approval of the reform.

• “Must offer” and “must carry” obligations for broadcasters will be established within the new regulatory framework.

4. New infrastructure opportunities

• Important opportunities for operator use of the federal infrastructure would be created by this reform. The Federal Government of Mexico would implement a program for sharing its infrastructure through the sale of wholesale capacity seeking to increase broadband penetration.

• The telecom infrastructure (other than dark fiber) of the Federal Electricity Commission (CFE) will be transferred to Telecomunicaciones de México (Telecomm), so that it can foster the use of the structure of the national electricity network of Mexico. It is important to note, in this regard, that Telecomm has also recently been appointed to operate the new MEXSAT satellite system of the Mexican Government.

• The spectrum for two new national television chains will be auctioned within 120 days of the approval of the reform. This auction will, as a practical matter, be the first auction for a national television system in the history of Mexico.

• The use of the bands of 700 MHz and 2.5 GHz will be reviewed in order to optimize its use in a shared, non-discriminatory, and continuous basis.

• Digital Terrestrial Television switch off (analogue to digital) is accelerated to occur by the end of year 2015.

5. New financing schemes

• The elimination of the traditional foreign investment controlling share restrictions opens up the Mexican telecommunications market to international capitalization.

• This capitalization could occur both in the stock market and as international debt structures.

• The deployment of telecom infrastructure could be financed from international markets and bankers.
Ecosystem of the reform

A number of players are involved in the reform, many of them with relevant economic, political and media influence in the country. In the following lines, a description of the key players of the ecosystem where the reforms will take place is detailed.

1. Political ecosystem

Executive Branch: President of Mexico endorsed and submitted the reforms to the Congress.

- The three major parties, Partido Revolucionario Institucional (PRI), Partido Acción Nacional (PAN) (right wing), Partido de la Revolución Democrática (PRD) (left wing), and the PRI-allied party, Partido Verde, essentially backed the reforms.

Legislative Branch (Congress):

- Upper chamber (Senate)
  - Transport and Communications Senate commission President, Mr. Javier Lozano

- Lower chamber (Representatives)

2. Private sector

- Major telecommunications operators and Broadcasting TV companies:
  - América Móvil, owned by the world’s richest man, Mr. Carlos Slim, holds the major fixed operator, Teléfonos de México, which controls 80% of fixed-telephone lines and around 75% of fixed-line internet connections. Additionally, América Móvil holds the major mobile operator, Telcel, which controls nearly 70% of cellular lines. Its subsidiary, Claro TV company, recently started to offer IP streaming television through Internet connections. Its bundled service, provided by Dish, has more than 15% of the satellite TV market.
  - Televisa Group, controlled by Mr. Emilio Azcárraga, is the world’s biggest Spanish-content media company and has 70% of the broadcast TV market, more than 40% of cable television and nearly 80% of satellite TV subscribers. Cablevisión, their cable operator, is gradually growing within the Internet access market.
  - TV Azteca, owned by Mr. Ricardo Salinas, controls the rest of the broadcast TV market.

- Other telecommunications operators and restricted TV companies:
  - Telefónica Internacional, an international operator based in Spain, is the second largest mobile operator with approximately 20% of the cellular-lines. Currently, Telefónica is limited to enter in the fixed line business due to foreign investment restrictions.
  - Iusacell, which is co-owned by the two major TV companies (Televisa and TV Azteca), controls a segment of the cellular-lines.
– Nextel, controlled by Nextel International Holdings.
– MVS
– Axtel

3. Industry organizations and lobbying groups

• Some members of the Congress in both chambers are known as “Telebancada” group, due to their linkages with the two major broadcasting TV companies.

• CANIETI
• CANITEC
• AMEDI
• CIRT
Our team

We have formed a task group with international and local experience, both on the legal side as well as on the business and financial sides.

**Acedo Santamarina, S.C.** is a Mexico City-based law firm with substantial experience in the corporate & telecommunications fields. For more than 20 years, our lawyers have been key leaders in the telecommunications industry in Mexico.

**Détente LLC** is a Washington, D.C.-based consulting group that provides investment banking, financial advisory and strategic consulting services to domestic and foreign governments and corporations. We have advised several international companies in their investment strategies in Mexico.

**Hogan Lovells** is a global legal practice with extensive telecommunications, satellite, cable, transactional, and project finance experience. We regularly advise major global operators and investors in cross-border transactions. We know the values and necessary skills to bring worldwide business to Mexico, and have worked extensively in-country on internationally driven transactions.

Together, Acedo, Détente and Hogan Lovells have worked on complex international transactions in order to make our clients succeed.

Together, we have the experience to provide to you the end-to-end support necessary to take advantage of the new business scenarios and opportunities that may be on the horizon in Mexico.

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ANTITRUST & COMPETITION

One practice area given a real leg up globally by the merger was competition; Venezuelan partner Bruno Ciuffetelli is a leading name in antitrust locally, although no one is managing to maintain a strong practice domestically right now, as the regulator has not been quorate for some time. Nonetheless, much of the firm's Latin American antitrust work has a Venezuelan nexus or includes the Venezuelan team – it is giving Cabot Corporation antitrust merger advice in five countries in the region because of an acquisition of a majority shareholding in a Venezuelan subsidiary, for example.

ARBITRATION

The firm has a very large and strong arbitration team, working on a number of critical cases at once; unlike other prominent firms in this list, their caseload has something of a bent towards commercial arbitrations, apart from some work for PDVSA. In Miami, Daniel González has good experience in Latin America, while Miguel Zaldivar combines his project finance work with arbitration; in Caracas, Gonzalo Rodriguez-Matos is well known. Edward Schorr does disputes work in New York. The firm has a stronger showing in infrastructure and energy cases, although far from exclusively; it has ongoing work relating to Ecuador, Chile, Panama, Brazil and Mexico, as well as Venezuela. The team is working for Pemex in a bid to nullify a US$300 million ICC award; the case has already been disregarded in Mexico, and the team are making progress to convince U.S. courts to do the same.

CLIENTS

Venezuela's state-owned oil company PDVSA, its subsidiaries, and the state itself have been a dominant presence on the firm's client lists in recent years, through the office in Caracas; also among state companies, significant work has been won for Pemex as well as for Ecuadorean state-owned hydro company Coca Sinclair, while Guatemala's Banco Industrial and Colombia's Protabaco are other local names. Spain's Iberdrola and brewer SAB Miller are also key clients in the region.

OFFICES

The key Latin American talent is found across offices in Miami, Madrid, Caracas, Washington, D.C., Houston, and New York, but the team has the support of 40 closely coordinated offices overall, including a large presence in Asia and Europe. The firm expects to see its Rio office up and running soon.