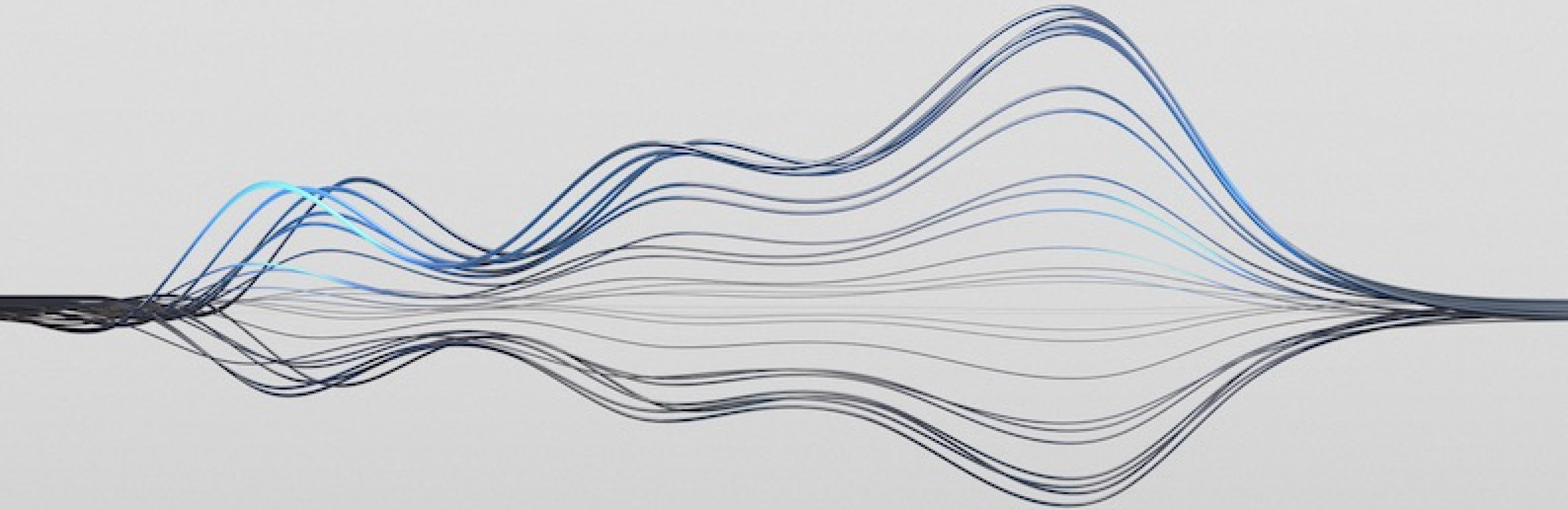
MEXICO

Global Guide to Directors' Duties



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Mexico

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Corporate entities

What type of company is typically used in group structures?

The most common forms of Mexican commercial business entities are the:

- Mexican Limited Liability Company (*Sociedad de Responsabilidad Limitada*) (**S. de R.L.**), in which contributions to capital are represented by equity quotas; and
- Mexican corporation (*Sociedad Anónima*) (**S.A.**), in which contributions to capital are represented by shares.

Both provide limited liability to the partners/shareholders and are governed by the Mexican General Law of Business Organizations (*Ley General de Sociedades Mercantiles*) (**GLBO**).

Note that the S.A. is the commercial entity that is usually preferred. However, some jurisdictions will tax the S. de R.L. as though it is a partnership, which gives the members resident in those jurisdictions certain tax benefits as though they were partners, in particular if those members are US resident and control the Mexican subsidiary.

Additionally, some S.A.s are governed by special legal frameworks such as the Mexican Stock Exchange Act (*Ley del Mercado de Valores*) (**LMV**). Unlike, those commercial entities governed by the GLBO, the LMV provides for a detailed legal regulation of the directors' and managers' duties, functions and responsibilities.

Those S.A.s governed by the LMV are:

- investment promotion companies (*Sociedad Anónima Pormotora de Inversión*);
- investment promotion for the stock exchange corporation (*Sociedad Anónima Promotora de Inversión Bursátil*); and
- publicly traded companies (*Sociedad Anónima Bursátil*) (**S.A.B.**).

Types of director

What is a "director"?

A director is an individual that may be appointed by the shareholders/partners' meeting (and exceptionally, by the board of directors in the case of S.A.B.s) and whose position is of a personal nature, is temporary and is revocable. Directors may be compensated or not, as so determined by the shareholders or the partners annually.

The personal nature of the role of a director precludes the position from being held through representatives. It is important to make a distinction between two different types of directors of a S.A.B. Such entities must, by law, appoint independent directors, and such independent directors must comprise at least 25% of the membership of the board of directors.

The function of all types of directors is to supervise the day-to-day management of the company, to achieve the goals set by the board of directors or the shareholders/partners (as applicable).

In particular, in the case of S.A.B.s, the main functions of their directors are to set up the company's main strategic priorities and to oversee the management of the company carried out by the Chief Executive Officer. The Chief Executive Officer of a S.A.B. (unlike S.A.s whose stock is not publicly traded) is for legal purposes considered as a corporate body itself (for further information, see Authority and powers).

What are the different types of director?

In essence there are three types of director: independent directors, directors appointed by the controlling shareholder(s); and provisional directors that are appointed by the board of directors of a S.A.B.

In case of the permanent absence of an already appointed director, provisional directors will remain in office until the shareholders' meeting appoints a new director replacing such provisional director or confirms that provisional director as a permanent director.

Capital stock companies may have one sole director or a board of directors; limited liability companies may have one sole manager or a board of managers.

If the shareholders/partners elect to appoint a board of directors/managers, the GLBO does not provide for a specific role for each member; however, it provides that, in case there is no designation on their specific roles, the first mentioned will be considered the president of the board.

Eligibility

Who can be a director?

Any individual can be a director of a company, even shareholders/partners. The only persons that are not allowed to be appointed to such position are those that are disqualified by law from practicing commercial activities, such as (i) notaries, (ii) public accountants, (iii) customs agents, (iii) judges, (iv) inmates for patrimonial crimes, and (v) unrehabilitated bankrupts.

Nevertheless, some types of Mexican commercial entities, particularly those that are supervised by Government Financial Agencies, including the Ministry of Finance and Public Credit (*Secretaría de Hacienda y Crédito Público*), the Mexican National Banking and Securities Commission (*Comisión Bancaria y de Valores*) (**CNBV**) and the Mexican Central Bank (*Banco de México*), among others, are subject to a special framework which makes it mandatory for them to appoint independent directors. Independent directors must fulfill certain minimum requirements that ensure their status as independent directors. Those that do not fulfill those requirements cannot be independent directors.

Minimum / maximum number of directors

The GLBO does not provide for a maximum number of directors. However, limited liability companies and capital stock companies that have adopted the variable capital structure, where management is entrusted to a sole director or manager, must have at least one manager/director; where management is entrusted to a board, such board must be composed of at least two members.

According to the LMV, S.A.s whose stock is publicly traded and investment promotion companies must always have a board of directors. For publicly traded companies, the board of directors must not exceed 21 directors, and at least 25% should be independent members.

Other laws applicable to specific types of entities impose requirements in relation to the minimum/maximum number of directors who may be appointed to the board of directors, as well as requirements regarding the number of independent members – for example: the board of directors of Mexican holding companies of financial groups (as well as boards of Mexican banking institutions, broker dealers, investment funds and insurance companies) must not exceed 15 members and must have a minimum of 5 independent members; and retirement funds must have a board comprising a minimum of five members, two of whom must be independent members.

Appointment and removal

How are directors appointed?

There are two methods through which a director may be appointed in a Mexican company:

- By appointment in the incorporation deed of the company. Such appointments are made in the transitory provisions of the incorporation deed. Such document shall establish in the bylaws if the shareholders agreed to either have a board of directors or opted to only have a sole director (with the exceptions for publicly traded companies, investment promotion companies, broker dealers, banking institutions, investment funds, insurance companies and retirement funds). As a rule, if the board of directors is composed of three members, the minority shareholders that represent 25% of the total shares may appoint at least one member. For publicly traded companies, minority shareholders that represent 10% of the total shares may appoint one director to be part of the board.
- Appointment by means of shareholders'/partners' meeting and/or unanimous written consent resolutions by shareholders/partners. The ability to pass unanimous consent resolutions and thus appoint directors in this way must be included in the bylaws of the company.

Provisional directors may be appointed for a temporary term by the board of directors.

How are directors removed?

The directors can be removed from their positions, either by a shareholders'/partners' meeting, or by unanimous written consent resolutions by shareholders/partners. The ability to pass unanimous consent resolutions and remove directors in this way must be included in the bylaws of the company. Also, a director may be removed if they become a unrehabilitated bankrupt.

Provisional board members

According to the LRAF, the LMV and the GLBO, the board of directors may appoint provisional board members, without the intervention of a shareholders' meeting, when only some of the directors are revoked and, therefore, they don´t meet the statutory quorum. Hence, in case of not meeting the statutory quorum, pending the new directors being appointed, the former board members will continue to serve in their positions for 30 days (at the most).

For entities that have only one director, the Statutory Auditor shall appoint the missing director on an interim basis.

In the case of financial holding companies (*Controladoras de Grupos Financieros*), the shareholders' meeting of the holding company can ratify such appointments or appoint the substitute directors at the meeting following the occurrence of such event.

Board / management structure

Typical management structure

The typical management structure of a company depends on the size of the company and how many partners or shareholders there are. Usually, if the company does not have many shareholders or has a distinctive group of shareholders/partners, a board of directors /managers is established to give every shareholder/partner a right to appoint a member to such board for it to vote pursuant to the instructions received by the respective shareholder/partner. The usual number would be three or any other uneven number of directors to avoid deadlocks.

As mentioned earlier, if the company opted to have a board of directors/managers to run the operations, the minority shareholders that represent 25% may appoint at least one member. For publicly traded companies, minority shareholders that represent 10% of the total shares may appoint one director to be part of the board.

First level officials and board members are required to perform their duties in such a way as to create value for the benefit of the company, without favoring a particular shareholder or group of shareholders. To this end, they shall act diligently, adopting reasoned decisions and complying with the other duties imposed on them by the Law or the company's bylaws. Therefore, both first level officials and board members are equally liable for any damages and losses derived from the functions that correspond to their roles and shall comply diligently with duty of care and diligence.

How are decisions made by directors?

Usually, decisions are made either by a meeting or through written resolutions. The ability to pass unanimous consent resolutions by the board of directors must be included in the bylaws of the company. Such resolutions must be signed by every director personally.

Unless the corporate bylaws provide for higher affirmative voting percentages, decisions taken by the board of directors or board of managers are valid and enforceable if taken by a majority of its members.

A recent amendment to the GLBO allows decisions to be adopted by the directors remotely (without the need for the meeting to be held at the corporate address of the entity) through the use of electronic, optical, or any other means of technology, provided that this is allowed by the company's bylaws.

Authority and powers

In most cases, the board of directors/managers or the sole director/manager are, because of their position in a company, granted all powers of attorney, which in general terms can include acts of ownership, administrative acts, lawsuits and collections, the ability to open bank accounts, issue or endorse debt securities, labor and employment activities and tax activities.

Furthermore, Chief Executive Officers (Director General) that run publicly traded companies are vested with the broadest powers to represent the company for (i) acts of administration, (ii) lawsuit collections, including special powers that, according to the law, require a special provision, and (iii) acts of ownership with certain limitations established by the board of directors. It is important to point out that the CEO of a S.A.B. is a body of the company, and they are in charge of running the day-to-day operations of the company and for ensuring that the strategic policies and controls set up by the board of directors are applied.

The oversight of a S.A.B. CEO's performance is a function that is delegated by the board of directors to an Audit Committee (*Comité de Auditoría*) and to a Corporate Practices Committee (*Comité de Prácticas Societarias*). The Audit Committee must have a majority of independent directors.

Delegation

To delegate powers of attorney, the board of directors should be appointed with the full authority to delegate such powers.

Duties and obligations of directors

What are the key general duties of directors?

Directors/Managers are obliged to confirm:

- That the shareholders/partners have made their contributions to the entity.
- That the legal and statutory requirements established with respect to the dividends paid to the shareholders/partners have been complied with.
- The existence and maintenance of the accounting, control, registry, filing or information systems provided by law.
- That the resolutions of the shareholders/partners' meetings have been exactly complied with.

What are directors' other key obligations?

Directors must carry out all their obligations established in the bylaws of the company, specifically (i) to take care of the business as if the director is one of the owners (*cuidar del negocio como si fuera propio*); (ii) the duty of loyalty, and (iii) duty of care or diligence.

Regarding the *duty of loyalty*, generally all directors should:

- maintain the confidentiality of the company's information;
- avoid conflicts of interest;
- if having conflicts of interest, disclose such situation to the disinterested directors or the decision-makers;
- ensure that the company´s interests prevail over their own personal interests in any decision-making as directors or managers;
- comply with the agreed policies for the approval of transactions with related persons;
- refrain from using insider information for their own benefit;

- use the assets of the company or of the controlled entities only pursuant to the approved guidelines, causing no damage or loss to the company (or the controlled entities); and
- not benefit from a business opportunity targeted at the company or the controlled entities, causing them any harm.

Regarding the *duty of care* or diligence, all directors must act in good faith and in the best interests of the company (and its the controlled entities) and are expected to:

- require timely, true and sufficient information about the company and the controlled entities, as they deem necessary for reasonable decision-making;
- exercise the duty of inquiry by monitoring those to whom they delegate the ongoing operation of the business;
- delay any resolution to be adopted by the board of directors when a member has not been called to the boards' meeting or when the board of directors itself is not completely informed about the matters to be discussed.

Transactions with the company

The directors that have an interest in a transaction with the company must expressly disclose such conflict of interest and refrain from participating in such dealing, and they remain subject at all times to the duty of loyalty previously mentioned. Additionally, audit committees must provide to the board of directors an opinion of the Chief Executive Officer´s performance and must make the board aware of the status of the company´s audit and internal controls in case any of the high-level officials don´t disclose information regarding conflicts of interests in any transaction that the company enters into. Further, the corporate practices committee must assist the board of directors with all observations/dealings regarding the performance of the relevant directors in relation to such transactions, as well as transactions with related parties, detailing the characteristics of the significant transactions.

Liabilities of directors

Breach of general duties

The liability of the directors may only be enforced by resolution of the general shareholders' meeting. That is, the shareholders must call for a meeting at which the liability of the director must be discussed and, once acknowledged by the shareholders, the meeting must decide whether or not to proceed with a liability claim against the director(s).

Shareholders representing at least 25% of the capital stock, may directly bring a civil liability action against the directors, provided that the following requirements are met:

- The claim must include the total amount of the liabilities in favor of the company and not only the personal interest of the petitioners.
- That, if applicable, the petitioners have not approved the resolution adopted by the general shareholders' meeting waiving the right to proceed against the defendant directors.

Additionally, any breach of the duty of loyalty may give rise to criminal penalties of up to 12 years' imprisonment for the offender. Fraudulent management is also considered to be criminal conduct and, therefore, may attract a 10-year imprisonment penalty.

According to the LMV and the LRAF, among others, all directors may be liable if:

- they abstain from attending, unless there is a justified cause in the opinion of the shareholders' meeting, the meetings of the board of directors and, if applicable, the committees of which they are members, and that due to their non-attendance the board in question cannot legally meet;
- they fail to disclose to the board of directors or, as the case may be, to the committees of which they are members, relevant information known to them which is necessary for proper decisionmaking in such corporate bodies, unless they are legally or contractually obliged to keep such information secret or confidential;
- they fail to comply with the duties imposed by the Securities Market Law or the bylaws of the company.

If found liable, they may be required to indemnify the company (and/or the legal entities it controls or in which it has a significant influence) for damages caused by their lack of diligence detailed above.

Liabilities on insolvency

Pursuant to Mexican bankruptcy law (*Ley de Concursos Mercantiles*), directors and key employees will be liable to indemnify the company in insolvency for the insolvency of the company when such directors and key employees:

- Vote at meetings of the board of directors or make decisions related to the debtor's assets, where there is a conflict of interest.
- Knowingly favour a certain shareholder or group of shareholders of the company, to the detriment of the other shareholders.
- Obtain without legitimate cause, by virtue of their employment, position or commission, economic benefits for themselves or procure them in favour of third parties, including a specific shareholder or group of shareholders.
- Generate, disseminate, publish, provide or order information, knowing that it is false.
- Order or cause the recording of financial transactions carried out by the company to be omitted, or alter or order the alteration of the records to hide the true nature of the transactions carried out, altering the financial statements.
- Order or accept the entry of false data in the debtor's accounts.
- Destroy, modify or order the total or partial destruction or modification of accounting systems or records or the documentation that gives rise to the debtor's accounting entries, prior to the expiration of the legal retention periods and with the purpose of concealing their record or evidence.
- Alter or order that the accounts or the conditions of the contracts be modified, make or order the recording of non-existent operations or expenses, exaggerate the real ones or intentionally carry out any illegal act or operation prohibited by law, generating in any of such assumptions a debt, loss or damage to the debtor's assets, for their own economic benefit, either directly or through a third party, or third parties, including the registration of liabilities in favor of the persons with conflict of interest.
- In general, carry out intentional acts, act in bad faith, or otherwise, carry out acts which are illicit in accordance with this law or other laws.

Additionally, during the conciliation stage of bankruptcy proceeding, directors must always act as diligent managers in their own business, and will be liable for any loss or damage suffered by the company due to their fault or negligence. If the removal of the director from the administration is declared, the conciliator shall assume, in addition to their own powers, the powers and duties of administration attributed to him by the law. Thus, the conciliator will have to act as a diligent administrator acting in their own business, and will be liable for any loss or damage suffered by the company due to their fault or negligence. Likewise, the conciliator must take the necessary steps to identify the assets owned by the director declared in insolvency proceedings that are in the possession of third parties.

Further, the conciliator must oversee the director/board of directors´ of the company, to prevent the sale of assets or any fraud on creditors, otherwise they could also be subject to a criminal sanction.

Other key risks

Another potential risk is that the director has an interest in a transaction that is contrary to that of the company. If the director does not abstain from any deliberation and resolution on such a transaction, the director is liable for any damages caused to the company.

Protection against liability

How can directors be protected from liability?

The *business judgment rule* shields directors and managers from liabilities for decisions that result in losses to company, to its controlled entities or to those over which the company has significant influence, provided that they comply with the required standard of care and loyalty. The law and the principles of corporate governance view the business judgment rule as a *safe harbor* for a director or manager who makes decisions in good faith and in the best interest of the company and its controlled entities while complying with legal and the corporate by-laws provisions. There is a presumption that the directors and managers will perform in accordance with the business judgment rule and will comply with the *duty of care* and *duty of loyalty* to which they are subject. However, such presumption will be lost if it can be shown that the director or manager acted fraudulently, illegally or with a conflict of interest.

In case of any infringement of any of those principles, the affected company may not agree otherwise, or provide in its bylaws for, any benefits or exclusions of liability, the purpose of which is to limit, release, substitute or compensate the director/manager for any liability incurred by them arising from the infringement of their duties.

Hence, all directors that breach their duty of loyalty must indemnify the company for the damage caused by their acts or omissions, and companies can´t put in place in favor of any person any insurance, bonds or guarantees covering the amount of such indemnity.

The director(s) will be personally liable for any breach of their duties – in particular if they breach the duty of loyalty, disclose false information to the stock exchange, hide material information, include false information accounting statements of the company or its controlled entities, and destroy any kind of information that may be useful for any investigation of the CNBV.

What practical steps can directors take to avoid liability?

They should ensure that each major decision is approved in writing by the shareholders/partners and that they comply at all times with their duties – namely, the duty of diligence, the duty to act in good faith, the duty of loyalty and the duty to take care of the business as if they were one of the owners.

D&O insurance cannot be acquired to protect a director for breach of the duty of loyalty. By law, such insurance coverage is forbidden in the case of publicly traded companies and other financial entities regulated and supervised by Mexican financial services agencies.

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