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Regulation of Timeshare Products in Mexico

In Mexico, sales and marketing activities with respect to timeshare products are regulated by general civil and commercial law, and more specifically by the Federal Consumer Protection Law (*Ley Federal del Consumidor*; the "Profeco Law"). Financed transactions are also regulated by the recently enacted Truth in Lending Act (*Ley para la Transparencia y Ordenamiento de los Servicios Financieros*; "TILA") and their implementing regulations. Recent revisions and amendments to these bodies of law have had a significant impact on how developers, operators, and sellers of timeshare interests (indistinctly, the "Timeshare Entities") do business in Mexico.

As our practice and involvement in the Mexican timeshare industry continues to grow, we have noted that a substantial number of Timeshare Entities have failed—often unwittingly—to comply with these recent changes and are uncertain as to how to adapt to the ones to come. In this article, we provide a summary of the applicable legal framework, with an emphasis on the Profeco Law, Official Mexican Norm 029-SCFI-1998 for the Commercialization of Timeshares (the "Timeshare Norm"); the proposed revision to the Timeshare Norm (PROY-NOM-029-SCFI-2007, the "Draft Norm"); the TILA and the TILA General Provisions for Contracts of Adhesion, Marketing, Statements, and Receipts issued by Commercial Entities (the "TILA Regulations"). In addition, this article highlights the need for fractional interest regulations and provides some insight on the resources available to developers of fractional products under the current legal framework.

"Timeshare" under the Profeco Law

The Profeco Law, enacted on December 24, 1992, defines and regulates timeshare as "a service, regardless of the name or form given to the legal transaction, which consists in placing at the disposal of one or more persons the use, enjoyment and other agreed rights over a certain property or part of the same, in a variable unit within a determined class, for pre-agreed periods, against payment of a certain amount, without transferring, in case of real property, ownership over the same."[1] This definition views timeshare as a service that allows the purchaser to access, use, and enjoy a vacation unit for agreed time intervals—expressly ruling out the acquisition of any real estate interests in such unit. The Mexican definition of timeshare, which contemplates only "right-to-use" timeshare activity, contrasts with the definition of timeshare in most U.S. jurisdictions, which generally subject both "deeded" and "right-to-use" timeshare product to their timeshare laws and regulations.

For purposes of illustration, the California Vacation Ownership and Time-share Act of 2004 defines "time-share estates" as "the right to occupy a time-share property, coupled with a freehold estate or an estate for years with a future interest in a time-share property or a specified portion thereof." The California Act also includes a definition of "time-share use" as "the right to occupy a time-share property, which is neither coupled with a freehold interest, nor coupled with an estate for years with a future interest, in a time-share property." Thus, California regulates as "time-share" both "deeded" and "right-to-use" timeshare products. The different definition of "timeshare" under the Profeco Law, however, may have been conducive to the development of the timeshare industry in Mexico for several reasons.

First, the Mexican Constitution and Foreign Investment Law prohibit non-Mexicans from acquiring direct ownership of residential real property located within the Restricted Zone, which is the area located fifty (50) kilometers from the Mexican shores or within one hundred (100) kilometers from Mexican borders. Consequently, non-Mexicans, who intend to purchase and own residential real property within such area, may only do so as beneficiaries of a trust or *fideicomiso*.[2] In a nutshell, a Mexican trust is similar to a U.S. trust, with one significant difference: under Mexican law, only Mexican financial institutions may act as trustees. Thus, in its most simple form, a trust can be explained as a fiduciary agreement under which the grantor (i.e., the non-Mexican) who intends to acquire residential real property located within the Restricted Zone, acting in good faith, transfers to a Mexican financial institution legal title (i.e., not ownership) to certain property located within the Restricted Zone in order to accomplish a specific purpose (to receive or grant to a third party, as beneficiary of the trust, the use and enjoyment of the trust assets). By excluding ownership of an interest in real property from the definition of timeshare, non-Mexicans may purchase and own a timeshare interest directly and without the need of a trust, which significantly simplifies, expedites, and minimizes the expense of timeshare-related transactions.

Secondly, by failing to convey an interest in real property, the timeshare product is freed from the complex co-ownership regulations which would otherwise be applicable. Most state Civil Codes in Mexico[3] provide that co-ownership exists when two or more persons are owners of an undivided interest in certain property, and each co-owner (a) is not be obligated to keep the property undivided, if it is capable of being divided; or (b) if indivisible, is entitled to force the sale of the entire property and divide the proceeds among the co-owners. The above, together with other applicable regulations, creates a challenge when dealing with

  

fractional interest products. That is why in the latter case of fractional products, it is a common strategy to use trust structures and sell beneficial ownership rights in the same instead of direct ownership to the unit and an undivided interest to the common areas. A trust structure is the preferred option because it (a) allows the developer to transfer to the purchaser the use and enjoyment of the unit, subject to the applicable declaration and provisions of the trust agreement; (b) creates fractional interests, the transfer of which is subject to the provisions of those same documents; and (c) creates a structure under which the developer and/or operator may guarantee continuity and uniformity.

Finally, the current definition under the Profeco Law allows the Timeshare Entity to develop and operate the resort and sell timeshare products without the need of subjecting the property to a condominium regime—although it may be advisable in certain circumstances to do so for entirely different reasons.

Timeshare Entities should also note that the Profeco Law and the Timeshare Act regard timeshare purchase contracts as "contracts of adhesion," which needs to meet certain requirements. Per the most recent revision of the Timeshare Act, enacted early this year, these requirements include certain disclosure and registration requirements for the sale or pre-sale of timeshare products and other more specific requirements for financed transactions. Thus, contracts for the sale of timeshare products must be revised to assure their compliance with the abovementioned regulations, as amended.

Timeshare Norm/Draft Norm

In essence, the Timeshare Norm does the following:

(1) Sets forth the general disclosure requirements and regulatory elements applicable to Timeshare Entities, for purposes of protecting the purchasing power and the satisfaction of the purchased service;

(2) Places particular emphasis in defining and regulating timeshare as a service without any real property interest being created;

(3) Allows timeshare products to be purchased and owned directly by non-Mexicans (i.e., without the need of an individual land holding trust);

(4) Sets forth, with greater detail, the requirements that the timeshare purchase agreements (deemed "contracts of adhesion") should meet;

(5) Requires the timeshare purchase agreement to include a five-day rescission period without any penalty, and the procedure and penalties in the event of purchaser's early termination—beyond the mandatory rescission period—or breach of contract; and

(6) Sets forth the requirements that apply to the offer and sale in Mexico of timeshare services to be provided in a foreign country.

The Timeshare Norm may soon be replaced by the Draft Norm, which has been approved by the Mexican Ministry of Tourism and Ministry of Finance, FONATUR, the Consumer Protection Agency ("Profeco"), the Mexican Association of Developers and Tourism Promoters of Timeshare (also known as ADEPROTUR), and other private and governmental organizations. The principal contributions of the Draft Norm are (a) recognition of the purchaser's privacy rights, prohibiting Timeshare Entities from using purchasers' information for marketing purposes or sharing the same with third parties without the purchasers' written consent; (b) requirement of less burdensome guarantees with respect to the performance of obligations under the timeshare purchase agreements than those required of Timeshare Entities under the Timeshare Norm; and (c) establishment of less onerous requirements for the termination of the timeshare service. These changes will require all Timeshare Entities to modify their purchase contracts and some of their business practices accordingly.

Financed Transactions

The TILA and TILA Regulations, enacted in May 2008 and amended on June 25, 2009, apply to timeshare purchase agreements, where the purchase was financed by the Timeshare Entity, and also to the corresponding marketing materials and Web site publications. Among other requirements, the TILA Regulations provide that all such timeshare purchase agreements must

- Be drafted in Spanish;
- Be divided in chapters or sections that make their reading and interpretation easier, and facilitate the Client's

comparison of the services offered against those offered by similar entities;

- Be printed in at least 8-point type;
- Include the type, amount and method for calculating interests and commissions, in compliance with the TILA requirements;
- Include the total amount owed;
- Comply with Profeco registration requirements with respect to timeshare purchase contracts; and
- Include and describe a service cancellation process.

The TILA Regulations also include a form of "cover page," which TILA requires to be used for all timeshare purchase agreements. Note that some of the information to be included in this mandatory "cover page" should be further detailed by the Timeshare Entity in order to prevent litigation. For instance, the form states that, where the purchase price is denominated in a foreign currency, the parties should refer to the Mexico Central Bank Web site (**www.banxico.org.mx**) in order to determine the exchange rate. However, the form fails to recognize that the Central Bank publishes several rates and that such rates may vary during any day. Some of the different rates include (a) FIX rate, which is published at noon and determined based on the average rate of the currency exchange market for transactions payable within two (2) business days; (b) the FIX rate published that day on the Federal Official Gazette (i.e., the FIX rate published the preceding business day, at noon); and (c) the rate for making payment of obligations denominated in a foreign currency and payable in Mexico.

The following chart shows how these different rates may vary:

DATE	FIX 2/	FIX (Official Gazette)	For Payments
2/20/2009	14.8163	14.5505	14.6725
2/19/2009	14.5505	14.6725	14.6118

These rates show a maximum difference of 1.8267%, which may seem irrelevant. However, on certain occasions, the difference may have a greater impact, as shown below:

DATE	FIX 2/	FIX (Official Gazette)	For Payments
10/08/2008	13.0417	12.1196	11.7667
10/07/2008	12.1196	11.7667	11.1188

In the above example, assuming that the corresponding payment was due on October 8, 2008, the differences between rates could have resulted in a loss (or gain) of up to 10.8356%!

Another relevant provision of the amended TILA requires Timeshare Entities (in financed transactions) to deliver statements to their clients by mail (or otherwise agreed-on means) on a regular basis and at no cost to the client. These statements shall be drafted in clear and simple terms, and reflect all information relevant to the transaction, so the client may perfectly understand it and compare the same against similar transactions.

Taxes and Financing Structures

Because a large portion of timeshare purchasers are either citizens or residents of the United States, a withholding tax obligation on the part of such purchasers may be created when they remit interest payments to the Timeshare Entity if the latter is a corporation organized and existing under the laws of Mexico. Thus, Timeshare Entities should explore whether a portfolio interest trust arrangement (or other type of structure) may be implemented as a convenient vehicle for dealing with this issue. It should be noted that, under certain circumstances, the implementation of a portfolio interest trust may also serve as a convenient financing vehicle, with the lender (a) being named a beneficiary of the trust, (b) accepting a pledge of the ownership interest of the beneficiary in and to the trust, and/or (c) accepting a pledge by the trustee of the individual notes receivables forming the corpus of the trust.

There are many timeshare entities which, for various reasons, continue to use outdated and/or incomplete or unregistered timeshare purchase agreements, thus exposing themselves to unnecessary risks.

Conclusion

Timeshare Entities should use well crafted documents in order to comply with the requirements of all applicable Mexican laws and regulations and avoid the risks of litigation. Unfortunately, there are many Timeshare Entities which, for various reasons, continue to use outdated and/or incomplete or unregistered timeshare purchase agreements, thus exposing themselves (and timeshare purchasers) to unnecessary risks. To minimize such risk exposure, Timeshare Entities should consult with experts in

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the field and, if necessary, revise their contracts and business practices as needed to comply with the laws and regulations currently in effect in Mexico. The same is applicable to fractional interest product developers, owners, and operators (and their attorneys), who need to be cognizant of the legal framework applicable to fractional interest products and the regulatory differences between timeshare and fractional products.

In addition, Timeshare Entities should receive constant and knowledgeable legal and tax advice that would enable them to take full advantage of any opportunity created by U.S. and Mexican legislators in their efforts to modernize the law and create a statutory and regulatory framework that meets the demands of the modern business world, while also protecting individual purchasers and stimulating the economy. D

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Endnotes

1. Federal Law of Consumer Protection, Article 64.
2. Article 10.
3. See for example, Articles 1964, 1965 and 1966 of the Civil Code of Quintana Roo (and thus applicable in Cancun, Cozumel, and the Riviera Maya), and Articles 926, 927, and 928 of the Civil Code of Baja California.

Substantial Completion—...(cont)

doing punch list work. Many owners do away with the concept of Substantial Completion entirely in their contracts. Owners and contractors can negotiate the weight, if any, to be given to any date of Substantial Completion, regardless of how determined (or by whom it is determined).

There are myriad solutions (many that are acceptable to both the contractor and owner) to determine the expectations and standards for Substantial Completion. The most important step is to set those standards at the beginning of a project—not to fight about its meaning at the end. D

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Humble Beginnings...(cont)

challenge of devising a way to recoup the money he needed to spend on renovations. After someone mentioned the concept of timeshare, he attended a conference in Miami and was introduced to RCI and II, which then led to the hotel's conversion to a timeshare resort in the mid-1970s.

As the above examples demonstrate, the road into the industry is not always a conscious choice or even one that is considered while obtaining an education. However, no matter which path taken, all of the leaders and professionals have thoroughly enjoyed their career and could not imagine themselves in any other industry. D

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