LATIN LAWYER INSIGHT

The Guide to Mergers and Acquisitions

Editors
Paola Lozano and Daniel Hernández

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First Edition

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Publisher's note

Latin Lawyer is delighted to publish *The Guide to Mergers and Acquisitions.*

Edited by Paola Lozano and Daniel Hernández of Skadden, Arps, Slate, Meagher & Flom LLP and containing the knowledge and experience of more than 40 leading practitioners, it provides guidance that will benefit all practitioners acting in Latin American mergers and acquisitions.

M&A activity in Latin America has grown significantly in recent decades and deals are increasingly complex. This guide draws on the expertise of highly sophisticated practitioners to provide an overview of the main elements of deal-making in a region shaped by its cyclical economies and often volatile political landscape. Its aim is to be a valuable resource for business-people, investors and their advisers as they embark on an M&A transaction.

We are delighted to have worked with so many leading firms and individuals to produce *The Guide Mergers and Acquisitions*. If you find it useful, you may also like the other books in the Latin Lawyer series, including our *Guide to Corporate Compliance and Regulators*, our online tool that provides an overview of the major regulators in Latin America.

My thanks to the editors for their vision and energy in pursuing this project and to my colleagues in production for achieving such a polished work.

Rosie Cresswell, *Deputy Publisher*

Introduction

Paola Lozano and Daniel Hernández[1]

M&A activity, comprising transactions involving mergers, acquisitions, dispositions and other corporate arrangements that entail the combination or consolidation of two or more businesses or the transfer of interests in a business, is a global industry worth trillions of dollars annually worldwide and billions of dollars annually in Latin America. In the region, deal volumes and values have followed a path of exponential increase in the past 30 years, despite the cyclical nature of M&A and the volatility of the political, social and macroeconomic environments in many Latin American countries. With increasing deal volumes and a broader range of market participants, the sophistication of legal counsel, business people, bankers and other advisers has also increased significantly. M&A in the region is constantly evolving and requires all participants to monitor current topics and new trends. Advisers are required to stay abreast of recent developments, in addition to providing deep substantive knowledge of technical legal matters, to add value to their clients. New challenges resulting from a dynamic, ever-changing landscape demand rigorous attention to the many variables that may impact an M&A transaction, which, in addition to the proposed terms of a particular deal, include market conditions, regulatory and legal changes, relevant case law and arbitral precedents, and newly implemented structures and technical contractual features developed by seasoned parties and advisers around the world, especially in deeper, more developed M&A markets.

This guide is designed to provide an overview of certain critical aspects of current M&A deal-making from the perspective of a highly qualified and diverse group of experts in their field throughout the larger markets in Latin America, as well as from the United States and Spain. This guide is not meant to be an academic description of applicable laws or contract terms and conditions typically included in M&A agreements. Instead, we selected current topics of interest in areas of recent and expected continued evolution, as well as certain

1 Paola Lozano is a partner and Daniel Hernández is an associate at Skadden, Arps, Slate, Meagher & Flom LLP.

factors that we believe may drive increased M&A activity in the years to come, with the aim of creating a valuable resource for executives, board members, investors and attorneys (both in private practice and in-house counsel) as they embark in an M&A transaction.

As we set out to create this guide, the worst and most widespread global healthcare crisis the modern world has known – covid-19 – erupted. This fact required all M&A counsel to reassess priorities, focus on substantive and immediate issues (many unprecedented), quickly adapt to a new reality, and get creative in the use or development of tools to address the negotiation, execution, consummation, and in some cases, termination and amendment of M&A transactions.

Against that backdrop, Part I of this guide is an edited transcript of a roundtable discussion on the impact of the covid-19 pandemic on M&A in Latin America, held in August 2020, where Paola Lozano of Skadden in New York, as part of our role as editors of the Guide, moderated a panel of leading M&A practitioners working in the region who are based in Argentina, Brazil, Chile, Colombia, Mexico, Peru and Spain. The discussion addressed deal certainty in uncertain times from the perspective of New York and Delaware case law, as well as from the perspective of the civil law systems represented in the roundtable. The panel discussed whether, in the midst of the pandemic, parties to previously signed and announced M&A deals were obliged to consummate such deals on their documented, agreed upon terms, or whether there were paths to amend or terminate those deals on the basis of the unforeseen intervening facts and their impact on the target. The panel also discussed the difficulty of agreeing on target valuation as a result of the impact on the underlying businesses of the health crisis and the measures imposed by national and regional governments to addresses it, which became one of the most significant negative pressure points detracting from M&A volume in the region in the first half of 2020. The panellists presented some tools practitioners have at their disposal to help bridge the gap on valuation between buyers and sellers, such as earn-outs, modified purchase price adjustments and performance-based closing conditions. Finally, the panel discussed the expectations for 2021 M&A activity and some of the challenges and drivers that could impact market appetite for local targets, including the significant role that will be played by national governments in the region, as they implement policies to address the crisis and its aftermath.

Part II examines Latin American M&A transactions from the perspective of various types of market participants and how their involvement deeply impacts the nature of the process and the terms of the transactions.

Claudia Barrero of Philippi, Prietocarrizosa Ferrero DU & Uría in Colombia discusses the particularities of M&A transactions involving multilatinas, and their impact in the region and beyond. This chapter underscores the relevance of multilatinas in the recent evolution of the Latin American M&A market as strong drivers of transaction volume. Their very practical approach to deal-making and ability to quickly adapt to particular market conditions have made them increasingly competitive, as compared to other global players interested in Latin American targets.

Maurizio Levi-Minzi, Peter A Furci, Andrew M Levine and Jonathan Adler of Deveboise & Plimpton LLP in New York address M&A transactions involving private equity funds and other institutional investors, including intrinsic challenges thereof and recommended protections in partial acquisitions.

Jared Roscoe and Stephen Pelliccia of SoftBank in Miami discuss certain transaction terms expected by a US-based venture capital fund in their investments in Latin America and the need to adjust certain forms developed in Silicon Valley to the factual circumstances and complexities of the region.

Sergio Michelsen, Darío Laguado and Ángela García of Brigard Urrutia in Colombia provide a practical overview of M&A deals involving family-owned businesses, and the many particularities and complexities involved in such transactions. The chapter describes deal dynamics, as well as substantive issues prevalent when representing a family-owned business or its counterparties in a transaction, including the need to ascertain early on the power structure and the alignment of interests and objectives within the family group.

We close Part II with the insight provided by senior Latin American M&A investment bankers, Vanessa Dager and Nicolas Camacho of Credit Suisse in New York, who give us an overview of the critical role of investment bankers in assessing, structuring, organising and conducting an M&A transaction, particularly in the context of international sell-side auctions of Latin American businesses.

Part III covers types of transactions and evolving trends that are fairly new to Latin America and that we expect will continue to increase in volume, size and importance, potentially becoming a helpful driver of the resurgence of M&A in post-covid-19 times.

Francisco Antunes Maciel Müssnich, Monique Mavignier and Ana Paula Reis of BMA Barbosa Müssnich Aragão in Brazil discuss public company M&A, hostile takeovers and shareholder activism from the perspective of the Brazilian market. The article underscores the larger size and depth of the Brazilian capital markets, as compared to other jurisdictions in Latin America, and highlights the relationship between the evolution of the trading markets and the development of additional types of M&A transactions that are common in developed markets but nascent in Latin America, such as hostile takeovers.

Fulvio Italiani and Giancarlo Carrazza of D'Empaire in Venezuela discuss distressed M&A from the perspective of the Venezuelan market. The authors provide an interesting overview of lessons learned from the Venezuelan experience that may become exponentially relevant as distressed M&A is rapidly increasing in the region as a result of both the covid-19 crisis and the more generalised occurrence of economic downturns driven by political instability and social unrest.

Finally, Carolina Posada, Jaime Cubillos and Estefanía Ponce of Posse Herrera Ruiz Abogados in Colombia discuss deal-related litigation in Latin America, which is worth observing as a potential trend, following in the tradition of the common law jurisdictions that handle larger deal volumes and sizes, and have developed a robust body of case law around frequently contested topics in M&A. The authors draw interesting conclusions and note potential trends to develop in the region on the basis of a survey involving some of the most reputable Latin American firms.

Part IV addresses selected topics critical to M&A deal-making, outside the main transaction agreement, as well as a discussion on provisions within a transaction agreement that may impact certainty of closing.

Denise Grant, Augusto Ruiloba, Lisseth Rincon and Rita Ghanem of Shearman & Sterling LLP in New York address acquisition finance and debt structuring for M&A deals in the region. Naturally, the availability of an increased pool of sources of financing for M&A transactions has a positive impact on deal-making appetite, especially as lenders with strong balance sheets continue to take an interest in the region and develop a tailored approach to the facts that differentiate it from the larger, less volatile markets.

Pablo Mijares and Patricio Trad of Mijares, Angoitia, Cortés y Fuentes in Mexico provide their views on the negotiation and execution of preliminary legal documents. This chapter addresses important issues such as the preliminary nature and non-binding effect of letters of intent, memorandums of understanding and term sheets with respect to a transaction, and the binding effect of certain provisions often included in such documents. The chapter also provides an insightful overview of the main issues revolving around confidentiality agreements, exclusivity agreements and cost-sharing agreements.

Diego Pérez-Ordóñez of Pérez Bustamante & Ponce in Ecuador provides an overview of the particularities of due diligence efforts and risk assessment with respect to Latin American targets. The author combines remarks on some of the nuts and bolts of the interaction between due diligence efforts and the deal documents, with a practical overview of common due diligence findings for Latin American targets. He also discusses statutes of limitations (with a focus on Ecuadorian law), and trending issues such as the use of legal tech in due diligence.

Martín Cerruti, Geraldine Ifrán and Santiago Fontana of Ferrere in Uruguay discuss interim operating covenants and closing conditions in Latin American M&A deals. The chapter addresses antitrust and other regulatory approvals, key interim operating covenants, conditions to closing and termination rights.

Last, Luis Burgueño, Alberto Córdoba, Marisol Márquez and Elías Jalife of Von Wobeser y Sierra offer insights on escrow agreements, holdback provisions and other guarantees that may be used in the context of M&A transactions in Latin America. The chapter contains comprehensive remarks on some of the most critical issues typically related to escrow agreements, such as the selection of the escrow agent, the amount and term thereof, the use and beneficiary of interest accrued in the escrow account, and process and conditions for release of the escrowed funds. The authors also cover alternative mechanisms that may be relevant in Latin American M&A, such as parent guarantees, promissory notes and letters of credit.

We enjoyed the topic selection process and took great pride in editing each chapter of this guide. We thank each contributor for their time and appreciate the enriching exchange with each of the authors and collaborators. We hope the diverse experience and authoritative views captured in the guide will be very interesting and useful to attorneys, businesspeople and advisers in planning and preparing for their M&A transactions in Latin America. We expect to elaborate on these issues and other relevant and current topics in future editions of the guide.

The opinions expressed in this guide are those of the authors and not necessarily of their respective firms. The views expressed in this guide do not constitute legal advice. Each transaction is unique and any analysis thereof is necessarily impacted by the specific facts, circumstances and deal terms, as well as applicable law, which, among many other variables, may result in issues and conclusions that may significantly depart from certain general statements contained in this guide.

Part I

Covid-19 and Deal-Making in Latin America

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Roundtable: Impact of the Covid-19 Pandemic on Mergers and Acquisitions in Latin America

In August 2020, Latin Lawyer brought together a panel of leading M&A practitioners to discuss the immediate impact of the covid-19 pandemic on deal-making in Latin America, as well as how it could shape transactions in the longer term. This roundtable was moderated by Paola Lozano of Skadden, Arps, Slate, Meagher & Flom LLP and features contributions from Iván Delgado of Pérez-Llorca; Manuel Galicia of Galicia Abogados; Pablo Guerrero of Barros & Errázuriz; Luciana Tornovsky of Demarest Advogados; Estanislao Olmos of Bruchou, Fernández Madero & Lombardi; Alberto Rebaza of Rebaza, Alcázar & De Las Casas; and Jaime Robledo of Brigard Urrutia. The following is an edited transcript.

Paola Lozano: We have all been experiencing these unprecedented times from different countries and perspectives and yet there's a commonality in what M&A practitioners have been seeing and working on. This discussion addresses the main challenges and opportunities that the uncertainties brought by the pandemic have led us to focus on. I would like to start with a common question that we get from our clients. In light of these unprecedented events, when M&A agreements are already signed but pending closing, is there an opportunity for buyers and sellers to terminate or renegotiate the agreement?

New York and Delaware have a long tradition of agreements drafted to foresee the risk allocation in the case of intervening unforeseen events. However, case law shows that it is extremely hard to terminate agreements. There's one seminal case in Delaware, also used as precedent by New York courts, and that's the *Akorn, Inc v. Fresenius Kabi AG, Inc*[1] case, where a buyer successfully used the material adverse change (MAC) clause to terminate a merger agreement that had already been executed. The standard established by that case is extremely high.[2] Many of our clients have a tough time with the notion that in this unprecedented situation there may be no remedy to alter or terminate agreements entered at a time when these facts were not known.[3]

Luciana, what have we seen in Brazil in terms of folks trying to honour, terminate, or amend the terms of agreements during this pandemic?

Luciana Tornovsky: The pandemic has impacted the implementation of M&A transactions everywhere. Like many other countries, Brazil is discussing the effects of covid-19 in MAC clauses and reps and warranties. MAC clauses are commonly found in M&A agreements in Brazil. In the current scenario, parties involved in M&A transactions must analyse the scope and coverage of clauses that may exempt one party, or both, from complying with contractual obligations. Usually, MAC clauses allow for termination of the agreement and modification of conditions of the transaction. MAC clauses are often used as a condition for closing. They grant the buyer the right to terminate the agreement if certain events affect the rationale of the transaction. It is usually in the interest of buyers to use MAC clauses to terminate their contract before closing, in the event of exceptional events that compromise the rationale of the transaction. It's very important to carefully analyse and negotiate in detail the allocated risks, the situation in which they apply, the exceptions of their applications and the solution in case of disagreement about the relevance of the event.

1 *Akorn, Inc v. Fresenius Kabi AG, Inc*, No. 535, 2018 (Del. Dec. 7, 2018); *Akorn, Inc v. Fresenius Kabi AG Inc*, CA No. 2018-0300-JTL (Del. Ch. Oct. 1, 2018).

2 Among other things, the court stated that a MAC must 'substantially threaten the overall earnings potential of the target in a durationally significant manner'. In addition, in that case, the seller had made significant misrepresentations involving the regulatory status of the target.

3 During the course of 2020, a series of complaints have been filed in the US in connection with the impact of the covid-19 pandemic, including complaints seeking to terminate the agreement or delay closing, complaints seeking specific performance on the obligation to close the transaction and complaints relating to interim operating covenants and in connection with the closure of business locations due to the pandemic. Such complaints have resulted and may continue to result in settlements or judicial opinions issued after this panel discussion was held. For example, on 30 November 2020 (after the panel discussion) the Delaware Court of Chancery issued an opinion in *AB Stable VII LLC v. Maps Hotels and Resorts One LLC*, allowing the buyer to terminate the agreement and refuse closing, among others, because seller's actions in response to covid-19, without obtaining buyer's consent, amounted to a material breach of seller's covenant to operate the business in the ordinary course, consistent with past practice. The court examined the specific wording of the covenant at issue, such that it expressly included the words 'only' and 'consistent with past practice', and concluded that the parties had created a standard that 'looks exclusively to how the business has operated in the past' and which did not allow the court to look at how similarly situated companies responded to the pandemic. The court, however, did not agree with the buyer that that the impact of the covid-19 pandemic amounted to a 'material adverse effect'. The court found that the impact of the pandemic was excluded from the definition of 'material adverse effect' in the agreement, via carve-outs relating to 'calamities', 'general changes or developments' in the relevant industries, changes in 'general economic, regulatory, political or market conditions', and ('arguably') 'natural disasters', among others. (see *AB Stable VII LLC v. Maps Hotels and Resorts One LLC*, CA No. 2020-0310-JTL (Del. Ch. Nov. 30, 2020)).

A key question here is: does the covid-19 pandemic constitute a MAC under existing agreements? Unfortunately, I cannot give you a straightforward answer because it should be analysed on a case-by-case basis. Under Brazilian law, MAC provisions should be interpreted narrowly to find the real intent of the parties when they negotiated the wording of the definition of MAC events in the agreement. Extreme events such as the covid-19 pandemic impose a retraction on the world economy - nobody can deny that – and in turn affect the consumption rates of products and services, the reduction in the market values of assets, and a strong fluctuation in currency exchange rates. All of this can lead to a material reduction of cash flow, receivables and the value of company assets. Asset pricing and risk assessment mechanisms allocated to each party should play an increasingly significant role, yet the economic impact of covid-19 is very difficult to quantify. Of course, you can include exceptions in the clause, but you should analyse the clause you include in the agreement because Brazil is a civil law country, meaning, unlike New York and Delaware, we don't have court decisions that can guide us. We should negotiate carefully.

Lozano: Manuel, I want to hear about the situation in Mexico as it's also a civil law country and therefore different from New York and Delaware on which the traditional MAC clauses are based. Do you find that you're drafting the provisions very differently from the New York and Delaware precedents? In Mexico, do you have your form of MAC provisions? Do those include common law and civil law concepts?

Manuel Galicia: In most cross-border and even domestic work, we use provisions very similar to the ones used in the US, and their purpose is the same: to allocate the risks between sellers and buyers. They are narrowly drafted and when we have recently analysed whether all these provisions would apply in the present situation, most of the existing contracts didn't foresee the pandemic as a MAC event. As a result of the foregoing, we will be changing our way of drafting in the future. It's going to change the way we perform due diligence and that will impact the way we draft reps, warranties and indemnity clauses. We need to segregate agreements into those that were signed before the covid-19 event and post-covid-19. As to whether agreements have been terminated or not, we faced one situation of a Mexican company doing business in the US in a sector that has been severely affected and, because of the way the agreement was drafted and subject to US law, there was no way to walk away from the transaction and the result was that the buyer had to file for bankruptcy.

In Mexico, as a general rule, parties do not rely on MAC provisions to walk away from a transaction, because it's so narrowly drafted and there are not many legal precedents in our system. The tendency for parties is to negotiate. In one example relating to the sale of a retail business that has been affected, the seller had the opportunity to ask or request specific performance because there was no provision in the MAC for the buyer to walk out of the transaction. Nevertheless, parties agreed to renegotiate. As Luciana was saying, there needs to be a broad analysis and an understanding of the specific characteristics of the transaction, including when it is happening and whether it was through an already-concluded bidding process. It's very hard to resume a bidding process after trying to sue somebody that failed to honour a contract. Mostly, in our jurisdiction, parties have been forced to sit down and renegotiate, mainly on pricing, but in some cases, like the retail sector, on a change of business model, as the pandemic has changed consumer habits. That makes the negotiation or renegotiation quite complex. This is not only a legal matter; it's a business matter that must be analysed very comprehensively.

Lozano: The practical outcome under New York and Delaware law is the same: at the end of the day, we are always looking at the parties' leverage, beyond what the agreement says. Even though you may have some contractual right as a seller to seek specific performance, if your buyer is unable to consummate the transaction, or may go bankrupt if it consummates the transaction, that does not solve the problem and a litigated resolution may take too long anyway. M&A practitioners must remember that, in addition to being extremely knowledgeable and technical, we have to be practical to be useful to our clients.

Let me switch to the theories of civil law that may be similar or different from the MAC provision. I believe in Colombia, Peru and other civil law jurisdictions there is a strong following of the *teoría de la imprevisión*, which is a theory under which contracts may be modified if circumstances have changed substantially. Jaime, can you tell us about what you have seen in Colombia and whether the *teoría de la imprevisión* or *force majeure* doctrines have been applied to fill the gap that the MAC provisions leave?

Jaime Robledo: Although we have theories of *force majeure* and a theory that under US law has been called hardship or extreme duress, the truth is that M&A practice in Colombia has been Anglo-Saxonised in the sense that all of our agreements follow the basic model of New York law-governed agreements. MAC provisions are very common, although as a statutory matter *force majeure* or a hardship theory could be invoked to walk out of a deal. To the extent that M&A provisions are adequately drafted, it is very difficult to allege or argue a hardship theory or *force majeure* to walk out of a deal. In general, the MAC clause is followed, but we exclude carve-outs. For instance, we exclude things like acts of God or unforeseeable events, or a general crisis in economic and financial markets. You can accommodate the pandemic into any of these concepts, certainly as a *force majeure* or an act of God event, but also as a general economic crisis, as that was one of the effects of the pandemic. It would be very difficult for a buyer to walk out of a deal by invoking that a material adverse effect or a material adverse change has occurred and simply saying that this is a *force majeure* or an extreme hardship event, because under Colombian law at least, we've got a lot of precedents where parties are free to allocate risks between themselves in the case of *force majeure*. If one of the parties decides to assume the full risk of *force majeure*, that party will bear the burden. The only way that a party can try to rebut or repudiate the agreement is if it demonstrates an abusive negotiation between parties. This would be very difficult to show in the case of two sophisticated parties negotiating an M&A deal.

The hardship concept has been invoked in terms of executory contracts rather than share purchase agreements. In claims for extreme hardship, typically one party demonstrates that during the life of the contract the rate of return of the investment will be completely different than what was expected when entering the contract. In the case of a sale, it would be very difficult to demonstrate that because as a rule, you buy a business for the rest of the life of the business. It is difficult to foresee that the business will not recover within the next 18 months or 24 months to the extent that the risk allocation wouldn't have to be borne by the buyer. In a case that we are dealing with right now, where we are on the side of the seller, the asset was a concession company and the MAC clause expressly excluded acts of God and general changes in economic conditions from the MAC definition. The buyer argued that they should be able to renegotiate since the agreement had a finite time and was supposed to offer a minimum expected return on investment, but the pandemic meant the infrastructure authority had suspended the collection of tolls, resulting in a completely different rate of return. Fortunately, the Colombian government said that it would recognise the suspension in the collection of tolls, either by extending the life of the contract or by allowing for an increase in tolls. There was not a lot of additional discussions. Even if you were going to go down the route of arbitrating that dispute, it would have been very difficult for the buyer to walk out of the deal or even renegotiate if the government had not been a willing negotiator. Most of our agreements are based in Colombia and generally subject to the jurisdiction of an arbitration tribunal, but they are not consistent. In any event, I still believe that it would be difficult for a party to walk out of a deal if they have a traditional MAC clause.

Alberto Rebaza: Unfortunately, in Peru, we do not have relevant jurisprudence that might help us to analyse whether or not an event could be considered as a *force majeure* event. Nevertheless, we might bear in mind that some administrative authorities have considered this pandemic as a *force majeure* event for several industries and economic sectors. Therefore, it might be important for every jurisdiction to look back and see previous events that have impacted their respective countries in such a significant way as covid-19. For instance, in Peru, we can draw on our experience of El Niño, the warm ocean current that hits our Pacific Coast, creating heavy rains that destroy cities and towns, factories and infrastructure, among other things. Even though it occurs more or less every five years, some authorities continue to consider El Niño as a *force majeure* event, and we do have jurisprudence where parties have been allowed to walk away from transactions or their contractual obligation due to El Niño. This creates a great risk to deals where a buyer or a seller could argue that this pandemic is a *force majeure* event based on past authority judgments or resolutions. Even though arbitration decisions are not public, I believe that a party trying to defend their case will have extensive administrative literature under Peruvian law to demonstrate that the covid-19 pandemic is a *force majeure* event. The outcome is hard to foresee.

Lozano: We have heard about regulators and governments themselves sometimes looking for ways out of onerous commitments and that becomes an enormous source of arguments for folks trying to apply a different standard to the typical M&A standard among sophisticated parties in New York.

Pablo Guerrero: In Chile, our civil code has a very short definition that says a *force majeure* event is an unexpected event that is impossible to prevent. We have to go to what the agreement says because, as in Colombia, even though we have a definition of *force majeure* and the general rule is that you are released from complying with an obligation when a *force* *majeure* event occurs, the parties are free to negotiate around that and it's very common for parties to assume the consequences of *force majeure* in different ways.

The first question is: what does the agreement say? Normally, the agreements in an M&A transaction have definitions that are very similar to what the civil code says. They refer to facts affecting the target or the parties, but not general conditions like a pandemic. Buyers generally have not been able to use MAC clauses to exit M&A transactions in Chile. Although there is very old case law that considers pandemics as *force majeure* events, you must go to what the agreement says and whether that *force majeure* event makes it impossible for the parties to comply with their obligations. Normally, no *force majeure* event makes it impossible for a party to pay a purchase price. Having problems with your business is not a reason to invoke *force majeure* in the sense that you have the possibility of complying with your obligations. When it comes to hardship or the theory of unforeseen events in Chile, it's safe to say that it's not recognised in our law or case law (except for a couple of arbitration awards that state that the theory of unforeseen events (*teoría de la imprevisión*) does apply in Chile). That said, because of the pandemic, two bills in Congress currently seek to incorporate the theory of unforeseen events into our law. We have talked a lot about the application of *force majeure* in agreements that have been signed but not closed, but as Manuel mentioned, what's going to happen in terms of future agreements? How are we going to negotiate these clauses based on the experience of this pandemic? It will depend on whether we're in a seller's market or a buyer's market. The parties will want to limit this uncertainty and what I've seen in contracts being negotiated right now is that parties typically exclude pandemics as a material adverse change event because they are aware that this is something that can happen, has happened, is happening and they don't want to take that uncertainty into future agreements.

There is an additional problem in the acquisition of public companies. In Chile, we have a mandatory tender offer requirement for certain acquisitions that have been included in the prospectus of the offer. Once you launch the tender offer you cannot renegotiate the price and you cannot revoke the tender offer unless there are certain objective conditions. The definition of those objective conditions in the context of a pandemic or a material adverse effect has never been easy and that will become harder.

Lozano: There are philosophical and policy reasons for the interpretation of MAC provisions under New York and Delaware law. One of the reasons courts demand such a high standard to allow buyers to terminate an agreement is because there is an intentional goal of the courts in these jurisdictions to be the forum where people come when they want certainty. A historical theory behind the MAC provision and its exceptions is that, on the one hand, the generalised risk – country risk, macro-economic risk, worldwide or geographical conflict, *force majeure* and acts of God – tend to be allocated to the buyer and, on the other hand, risks that are specific to the target sit with the seller through closing.[4] It's not by chance, which is why, when we find ourselves in a pandemic, even as unforeseen as it may be, it's deemed

4 This article does not address other provisions in which risk may be shifted to buyers, including limitations of representations and warranties or indemnities.

a generic risk that most buyers assumed when they signed that New York law-type agreement, subject to any non-customary variations in the specific wording of each document.

Iván, Spain and Europe are ahead of Latin America and the United States in terms of the evolution of the pandemic. Are there more definitive cases that have been resolved or situations that have played out sufficiently to see how European jurisdictions have dealt with this?

Iván Delgado: We are ahead of the crisis, but I don't think we are ahead on the clarity on how to solve this situation. I will convey to you seven short messages concerning Spain and Europe (other than the UK). First, as you all said, it is very difficult to get out of agreements. As a rule, it is very difficult to terminate or try to renegotiate if the other party is not willing. Second, we must differentiate or distinguish between share purchase agreements, when you buy a business or assets, and lease agreements. An example of the latter is one of the largest restaurant chains in the world trying to renegotiate or terminate all its lease agreements all around the world. In civil law countries, it is easier to terminate or renegotiate agreements that involve real estate assets, because if the asset is not valuable anymore you have an argument in accordance with the civil court not to comply with an obligation. The third message is MAC clauses are not regulated in our system. It's very common to negotiate and include MAC clauses in agreements, but there is no regulation, so you must fight to enforce them either in court or in arbitration. The fourth message is that we also have *force majeure* and the so-called called hardship concept, that we call *rebus sic stantibus* and is regulated under our civil code. This mechanism allows the parties to balance the situation in cases where there is an imbalance, such as this pandemic. When there is a MAC clause, we've seen clients trying to negotiate and enforce it in the courts or arbitration. When there is not a MAC clause our clients have been trying to use *rebus sic stantibus* to terminate their agreements, but it is very restrictive. The fifth message is that at the beginning of the pandemic in Europe people were trying to renegotiate in good faith, but it was not very successful, and parties didn't reach an agreement. All of them were suffering from the crisis so we were not able to find the right agreement for both parties in many, many cases. The sixth message is that we have recently seen more terminations and once the agreement is terminated, the parties want to fight, either in court or in arbitration, to recover the money that they believe they have lost between signing and closing because of the covid-19 pandemic. The final message is that we are ahead, but the arbitration decisions will give us guidance on what to do in the future.

Lozano: There are other provisions in agreements that we can use creatively to try to terminate contracts if we need to. One that comes to mind is the covenant to operate the business of the target in the ordinary course. In the US, if you are a buyer, once you are aware that it's going to be extremely hard to terminate the agreement based on the MAC provision, you start looking at breaches that allow you to say that the conditions to closing haven't been satisfied and, therefore, you are not obliged to consummate the closing and pay the purchase price. We have had some success renegotiating the terms by being able to prove factually that there has been a breach of some of the representations, warranties or covenants, specifically the ordinary course for a business covenant. Running a business in the ordinary course, consistent with past practice, in the middle of this pandemic has been virtually impossible.

Robledo: The way we generally export those covenants into our agreements in Colombia is to use the same language as in the US. You must make commercially reasonable efforts to maintain the business in the ordinary course, or you must use reasonable best efforts. Have the courts in the US already considered that? Even if sellers have taken all commercially reasonable decisions to maintain the ordinary course of business, would they still be breaching that covenant? In Colombia, it wouldn't be considered an end obligation, but more of a means obligation.

Lozano: Because the pandemic is still going on and the period for judiciary decisions has not been long enough, we don't have many resolved cases in the New York or Delaware courts on this, only a couple of pre-pandemic ones. The courts have said this analysis is extremely fact-specific. The courts in New York and Delaware are very clear that they don't look outside the agreement, to the extent the agreement regulates specific issues, like the ordinary course of the business covenant. But if you allocated the risk and said to the seller 'in order for you to receive this purchase price and these terms and conditions you need to run the business how you have run it before' then the courts will generally honour that. There's another very important thing, one of the traps for the unwary: if you represent a buyer, you can't just talk about ordinary course; you want to say ordinary course of business 'consistent with past practice'. The ordinary course may change. For example, it may become ordinary course in the pandemic that every company in retail is trying to switch from physical to e-commerce. But if a covenant says ordinary course of business 'consistent with past practice' then the courts will honour the intention of the parties to say 'for me to buy your business on these terms I expected consistency. I expected the same actions and facts of management that allowed me to price the business'.

The other issue is that the pre-closing period may be very long and what you could have done or the impact of the actions taken or not taken (which is often the more interesting question), may require extensive factual analysis. Often the failure is not by the act, but by omission because management or sellers didn't take all the action reasonable to preserve the business and the business relationships. When we're talking about the situations where we've been able to renegotiate, leverage is everything. It also depends on how many other offers the seller may have. In a couple of situations, credible threat of litigation was enough to bring the seller to the table and renegotiate. The key in the strength of the argument was not only the concept of past practice but also the exceptions to the covenant. Just like the MAC provision has some typical exceptions, usually, the ordinary course of business covenant will have some exceptions. Some of them will say, for example, that sellers and targets can depart from the ordinary course of business consistent with past practice if mandated by law or regulation. So, in one situation, buyer's argument was not palatable because the exception was there and most of the things that had or hadn't happened from the target's and seller's perspective were a requirement of the law. Given that governments mandated certain changes to address the pandemic, the business and the sellers had to depart from past practice because they would have otherwise been in breach of law and the contract.

We are going to be living with a pandemic for some time, so I want to talk about what are the mechanisms we can use to ensure that we can continue to generate opportunities for our clients while managing risk. Estanislao, what are you seeing and doing to create more M&A certainty?

Estanislao Olmos: Argentina is like Colombia in the sense that major transactions are made through US-style SPAs. Although we have in our civil code a full set of *teoría de la imprevisión*, *force majeure* and *caso fortuito*, or act of God, usually you have sophisticated lawyers when it comes to mid-level to complex transactions. You will typically see transaction documents contemplating MAC events as one of the conditions that would allow one of the parties to excuse performance, but I tend to agree that, in most cases, parties use that as leverage to resort to good-faith negotiation and even termination in good faith. Throughout recent history in Argentina, given that we suffer continuously from crises now and then, we have also come up with more specific clauses that deal with some of the recurrent consequences that occur as a result. One of those is tied to currency controls. In most transactions, the price is set in US dollars or another foreign currency and the purchase price is set to be paid abroad. You would also find a so-called 'Bonex' clause (Bonex referring to a publicly traded bond now replaced by other publicly traded securities) so that the buyer (or debtor) cannot excuse itself from paying the purchase price abroad and in foreign currency if the government resorts to foreign currency restrictions, which we have now and then. We have also developed over time specific clauses that deal with other government-related actions, which in most cases are the true contributing factor of our crises. We cannot deny the pandemic is a major and unforeseen event that has caused companies to suffer a lot, but in most cases, government restrictions worsened the situation.

As an example, back in the early 2000s when Argentina endured the *corralito* period [the economic measures taken at the end of 2001 to stop a bank run], which followed a decade of convertibility that ended abruptly in January 2002, you started seeing a lot of M&A activity in the banking industry. One of the key issues when selling a bank is that you cannot afford to be paying back the deposits if a bank run is triggered, so it's too much risk to leave it as a *force majeure* event. In one transaction, we had to build a specific industry risk test, so the seller could show that bank deposits would not go down to a certain level for the transaction to continue. On the seller-side, the purchaser had to put in place a facility abroad to support its obligation to keep deposits given back to the public after the closing. That was a very specific event for a very specific industry in a very specific time for Argentina, but when something like this happens, the agreements reflect the reality the following month and are kept there for years. The key issue is what are we doing now. A lockdown could be reinstated in some jurisdictions at any time, so, for example, in a manufacturing agreement, we are asking the manufacturer to have a disruption business plan, so that they can resort to a different facility to continue to provide and supply our client. You can only sometimes do that if parties are operating in different jurisdictions. It's fact-oriented, and you must be creative. Nowadays, you cannot say that the pandemic or a lockdown are unforeseen events.

We have already experienced them, and we know that a lockdown may be restored any time if the numbers of infections or deaths continue to increase. We are seeing parties be more flexible, in the sense of not building an interim period in a transaction if it is not necessary. If you need to carve out an asset, maybe it's a better idea to do it post-closing, or even to take the risk of closing without taking obtaining regulatory approval and then deal with the rest.

There are other matters that a lawyer needs to consider when a party has deferred the closing of a stock or asset purchase. One of the four-horse riders of the apocalypses is the bring down of the representations and warranties. If the seller has the right to update the disclosures schedule it will be a very stressful scenario for a purchaser in such a changing, uncertain environment. The bring down needs to be carefully designed to avoid being trapped in a scenario where you either must waive on closing but take all the updated risks that you didn't bargain for or walk away from the transaction. Some of the transactions are strategic, so it's not that easy to let the target go. That would create momentum for a re-trade at the very last moment, so careful attention should be paid to updates on disclosure schedules and the draft of the interim covenant. Of course, it's difficult to rule out that a seller would not be entitled to uphold that running a company in the ordinary course of business includes taking some extraordinary decisions and measures considering an extraordinary event.

We are seeing clients more interested in reducing the time between signing and closing or even making it go away. We have even gone further than that. We had a transaction in which we were representing the sellers and the buyer accepted that the due diligence is done after it signed a definitive share purchase agreement and the only exit of that transaction for the buyer was if they could raise issues out of the due diligence amounting to a certain level of price adjustment or potential indemnity claim – and only then to the extent the seller was not willing to accept the adjusted purchase price or to put up an escrow covering the potential indemnity claim, in which case the transaction needed to close as originally drafted. I have never seen that before, but it worked, and it was quick. I think we are going to get more flexible in terms of finding solutions to avoid this uncertainty because although the pandemic seems to be under control in some parts of the world, we know that there may be a second wave.

Guerrero: We have seen that a lot in Chile. We've seen a trend towards more lockbox mechanisms. That is, a deal that doesn't allow price adjustments. It has a fixed price and even if there's a time lag between signing and closing and intervening events there's no possibility to adjust the purchase price. I think that's part of the same trend of trying to eliminate sources of uncertainty in terms of price although it creates the need for more heavily negotiated conduct of business clauses and non-material changes in financial statements.

Lozano: Let's talk about other creative structures like earn-outs.

Tornovsky: Everybody is very curious to see what's going to happen with earn-outs. Considering the economic uncertainty, potential sellers and buyers may struggle to define enterprise value and agree on a purchase price. To address the uncertain valuations and forecasting difficulties we expect to see an increase in the use of earn-outs and other forms of contingent purchase price considerations in M&A transactions. These are clauses that entitle a seller to receive a future additional purchase price if the target business achieves certain performance targets. The seller essentially bets on the future performance of the business, and if correct then it would be entitled to additional consideration. There is also a scenario of no additional consideration being paid by the buyer depending on the economic performance of the company and the targets agreed for the earn-out. A buyer may also want to defer a portion of the purchase price consideration to ensure that the seller still has an incentive for closing. Identifying the right timing and metrics to correctly predict the future valuation is very tricky and due to the impact of covid-19, likely, a target company will not reach its financial target in the short and medium-term. In certain cases, the seller may lose part of the purchase price that has been negotiated as an earn-out. The key question is what will happen with agreements that had an earn-out payment based on the financial results of 2020? Should the earn-out provision be reviewed in this case? We should have in mind that both parties accepted to bear risk when they agreed to an earn-out and the conditions legally agreed on by the parties have not been implemented for reasons beyond the control of the buyer.

In Brazil, our civil code has a provision that establishes that agreements are ruled by the principle of minimum intervention. A contractual review is only accepted in very limited cases. On the other hand, there could be a clear case of price disproportion. The financial results of the company during a period of crisis may not represent its total production and sales capacity. If you consider that the crisis will pass after a certain time, the seller may seek the review of the earn-out arrangements. I think they have good arguments to say the negative consequences of the pandemic are transitory and non-recurring. Although the pandemic affects the company's results in one year, they are likely to normalise in subsequent years, so the effect of the company's value should be analysed over a longer time than initially agreed. The seller accepted the normal risks of the company's activities, including indications of future results, but should not suffer the losses resulting from the unpredictable inevitable transitory risk that does not affect the company's value in the long term. These effects should be excluded from the calculation of the earn-out and, in Brazil, we have a provision in our civil code that allows for review. It ensures that the debtor or the creditors can request the real amount to be paid as far as possible.

When extraordinary, unpredictable events make a contract excessively costly, parties could ask for the review of the agreement under the hardship principle. Both parties, in my opinion, have arguments that should be weighed against the circumstances of the specific case because it's established in the agreement. One of the elements to consider is the wording of the earn-out clause, which may bring greater protection to the buyer or the seller depending on how the parties have agreed on the earn-out. For instance, a provision that's more favourable to the buyer would say that the earn-out amount is subject to several factors outside the buyer's control. There is no guarantee that the sellers will receive a value for the earn-out and the buyer has not promised any value. This is just an example of things we could include in the agreement to protect the buyer and the same arguments can be used in the reverse if the company's results were positively impacted by the covid-19 pandemic

- for example, an internet streaming company or a supermarket. It's non-recurring and you must see the real value of the company. Another aspect to consider is whether the earn-out occurred before or after our knowledge of the covid-19 outbreak. In addition to an eventful revision of the earn-out calculation, attention should be paid to revising the payment terms because, of course, the adverse effects caused by the pandemic will also affect the finances of the buyer, which needs to pay for the earn-out.

Olmos: If you are representing a buyer, of course, you would push for certain clauses that make clear that you are not assuming a fiduciary duty concerning the seller's goal of achieving the targets and then collecting the fair purchase price. Is there any general rule that we in Latin America should consider or expect for implied fiduciary duties in the context of an earn-out? If we are representing a seller, are we sure that the buyer will run the company in a manner that will meet the targets? What happens if the company misses the target because of decisions taken as directed by the purchaser? Do we have a potential claim? In my recent experience, this has led to heavy discussions between the sellers and the buyer over the concept of who runs the company post-closing during the earn-out period. On the other hand, the parties should consider using more objective metrics, based on revenue instead of EBITDA, if the purchaser is contemplating merging the target into its group, which facilitate tracking the sales of services or goods that correspond to the purchased business without a major impact from the indirect costs or other revenues of the business. Sometimes, parties reduce tension in negotiations if the payout of the earn-out is arranged on a sliding scale, instead of an 'all-or-nothing' system. There have been all sorts of solutions, but we should keep in mind what New York law provides for if there is no mention of achieving or making efforts to achieve the targets.

Delgado: We are starting a few deals and discussing alternative structures for earn-outs in Europe. It's going to evolve. The concerns that the buyer and the seller usually have with earn-outs relate to the conduct of business in the future and how the target is fixed. First, how are you going to motivate the key managers? Who are the people who are going to lead the business in the future because the seller is no longer going to be there controlling them? The second is the option of not selling 100 per cent of the target, as that motivates managers to sell for a better price in the future, and the third element is how the business is run, including how you are going to build the business plan. What are you going to do with the costs, because normally when a new buyer comes into place, the company tries to adjust the cost as much as possible, and the third what are you going to do with Capex? What investments are going to be made to fulfil the targets?

Lozano: Fiduciary duties in Delaware and New York are specifically prescribed in the law and very often litigated. Fiduciary duties tend to be premised on a position of control or reliance. For example, when a party has a predominant position or for any reason is required to act in the best interest of the other party.[5] So fiduciary duties don't typically arise between opposing M&A transaction parties (even if they may arise for the parties' appointed members of the board of directors). A significant concern is that for earn-outs to work, there has to be enormous clarity on the metrics and the standard of conduct. If you are representing a buyer, you must depart from any concept of ordinary course of business, because the notion that you are going to buy a business to run it exactly as the seller did is not typically accepted. Often, the whole idea is that you can do better than the seller. As a buyer, you may also want to clarify that you don't have to incur extraordinary costs to achieve the agreed metrics. A good way to accomplish a shared risk between buyer and seller into the future performance of the target is through a partial or staggered equity transaction, which is very attractive. I see it both as an alternative to the earn-out and as a juxtaposition to it. If you have percentage equity that remains from the sellers then you most likely want to agree upon a business plan for the first few years. That business plan is a phenomenal way to ensure clarity on the obligations of the buyer related to the metrics for performance. They cannot do less, but they don't have to do more in terms of CAPEX, hiring people, changes in the business, etc. Now, when you don't have a partial equity deal, I would not advise a buyer to agree to any sort of business plan, for the same reason. It is not desirable to buy something and be beholden to strict commitments to the former owner wanted to do. In most cases, you are going to see changes in the workforce and you are going to see people trying to realise synergies - that's part of the opportunities the buyer is willing to factor into the price. The simpler earn-outs are where you assign an objective metric package without imposing this obligation on the buyer but understanding that New York and Delaware have an implied covenant of good faith. Also, if you have language that says reasonable efforts or commercially reasonable efforts should be used to seek to reach the metrics and you go into litigation you ought to prove that you considered, analysed and took informed decisions to act. And if you didn't take action you have to explain that such inaction was based on an educated exercise. So, the efforts provision is meaningful. Now and again you find specific things that a seller will want. We did have an example in the manufacturing sector where for the seller to accept an earn-out, they wanted to know that a certain plant wasn't going to be combined with one of the buyer's plants because they thought that would make it harder to reach the numerical metric. The detractors of earn-outs will say that, because it's so fact-specific and complex, it often leads to litigation. I see it as a great way to breach the gap on valuation because what we have right now, hopefully at the table end of the worst part of the pandemic, is opportunities. There are willing buyers and sellers, but there remains the uncertainty of whether the value is going to materialise, and earn-outs allow the parties to move those tests into the future when we will have more certainty.

Galicia: The earn-out provision presents an opportunity to get to a middle point to resolve a negotiation. The complication in many transactions is the uncertainty as to the future and of course, covid-19 is feeding this, but I don't think it is limited to that. In Mexico, we

5 The most typical regulated examples are the fiduciary duties of the board members to the company as a whole and all its shareholders.

are not only facing a health crisis, but also an international economic crisis and a domestic political crisis. This is a challenge for us as M&A lawyers. The health crisis is not over, but when it is, we will still be facing an economic crisis. We will be exposed to very complicated scenarios that will force us as lawyers to be more creative. I think that this brings us back to the basics of us becoming experts on different industries because discussions on earn-outs are going to be very difficult if we do not involve people who understand the target's industry. Unfortunately, we also need to help clients understand the political environment. This will also change our way of practising law. We will probably need to learn to collaborate with experts in other fields to have intelligent and rational discussions to help our clients.

Earn-out provisions have always been there, and we know that they are very tricky and an invitation to litigation, which is also fine if that resolves part of the problem. But I think we need to offer something different to our clients. In that respect, I would go back to what was said about trying to close transactions faster. In Mexico, we are limited by our antitrust rules and other regulators overseeing potential targets. We don't have failing business provisions that allow you to close the deal without clearance of the antitrust commission in this type of crisis. It would be very helpful to have those as it's very complicated to be able to shorten the period between signing and closing without them.

Earn-out provisions work much better when somebody retains equity. When we started doing M&A transactions, we were doing joint ventures. Investors like hedge funds or venture capital and private equity investors are more used to completing those types of transactions, and in those cases maintaining earn-out provisions and management could facilitate the closing of transactions. This is not theoretical. Some more flexible buyers could use this situation to make partial acquisitions with earn-out provisions. The risk of litigation will still be there, but some investors are better fit to do and close transactions in this uncertain environment. This is part of what we will experience representing private equity, hedge funds or venture capital investors. I like to have this positive view that M&A transactions will continue, but we will have more fun because challenges will be there but there are ways to resolve all these problems.

More practically, at the beginning of the pandemic, we were not able to meet with our clients, but we were able to close transactions. So, we adapted, and our system provides and recognises electronic signatures in agreements. We have tested them and used them, and I think the use of an electronic signature to facilitate transactions will be another development in our way of doing business. We will need to think about all those issues and become more practical to help our clients.

Robledo: At the beginning of the pandemic, the first concept we all resorted to if there was a gap in valuation was earn-outs, but when you speak to business people, you find out that might not be the best solution – not only because of all the things we have discussed, but maybe a buyer will not want to share in the future performance of the business or bridge the gap in valuation. We had to think outside the box about joint ventures and combinations in which there is not a full-blown sale and we are not just deferring the purchase price. One positive from this crisis is that it has made us less automatic in the way we negotiate

M&A deals. It's a little more creative, even in some of the cases in which nobody wanted to assume the risk of the uncertainty in the closing conditions. One of the things that we ended up proposing was borrowed from the break-up fees implied in best effort covenants, or financing conditions in some deals. You put in a breakup fee so if you did not meet the financial metrics, not only because of the poor performance of the management but because of the impact of the pandemic, you were able to walk out of the deal with a breakup fee and nobody was fully assuming the risk. I think we're going to have to develop a longer and more detailed menu of potential solutions for our client in terms of dealing with uncertainty.

One of the main risks in the pandemic for some companies was the risk of collections from certain clients in the future. One way in which we bridged the valuation gap was to assign all the accounts that were going to be collected to the seller so that they would bear the risk of collection. They were paid a portion in cash and the other portion was paid for the endorsement of those invoices.

Guerrero: A lot has been said about earn-outs and there is a consensus that we will see more of those in the future, but I am not completely sure about that. I have always seen earn-outs as a way to bridge a gap in valuation, but also a way for sellers to signal confidence in the business and their ability to run the business because earn-outs are normally related to the seller remaining as a shareholder and having a role in the running of the business. It's a way to say 'I trust the business I am selling and that's why I am willing to take the risk of the future for certain years.' I don't know if that willingness to assume the future of the risk of the business is going to be greater in the context of more uncertainty. I would expect sellers to be more reluctant to use earn-out mechanics because of the complications of extraordinary events when calculating an earn-out.

Rebaza: I would like to highlight the importance of due diligence. At times of high risk, due diligence becomes particularly useful and indeed crucial for M&A deals. For instance, there is a direct connection between costs incurred due to the pandemic and an eventually agreed earn-out clause, since companies today are assuming protocols and an endless number of measures that cost a lot of money and affect their financial results. I do not doubt that parties negotiating an earn-out clause will have a very detailed discussion on whether those costs should impact a particular company's EBITDA. Eventually, when this crisis ends, some of those costs will not continue and a company's financial results (including the EBITDA) should go up. There are several very concrete and useful aspects of the due diligence that will be critical for these discussions since the effect of the pandemic will vary significantly case to case.

Another risk that I am concerned about is political risk. Not in terms of who will be the next president in any given country, but material changes to current regulation affecting some industries. Currently, we are seeing a lot of intents and efforts not only in the Peruvian Congress but also in several Peruvian agencies to impose more control, more requirements, more administrative burden to companies in different sectors and different ways, such as employment regulation, price controls, limits to interest rates and environmental regulation, etc. Something similar can be seen in many other countries in the region. Therefore, I strongly believe that we must conduct due diligence not only of the target but also the sector and the legislative, regulatory and administrative activity related to the target. We have to know what bills might be approved and might affect our clients' potential targets. That kind of intelligence will be very important and critical to discuss a MAC clause in the share purchase agreement. I believe that profound and well-executed due diligence will be more important than ever to identify risks and support more complicated and detailed negotiations in a turbulent period like this.

Lozano: Agreed. In places like Peru that have been very hard hit by the pandemic, government regulations have been one of the significant factors negatively impacting businesses and M&A transactions, maybe more than the health crisis itself. One of the major impediments for simultaneous signing and closing and one of the things that impacts due diligence is the antitrust review. Has the law on pre-merger control been delayed in Peru due to the pandemic?

Rebaza: Yes, until March next year. Unfortunately, this crisis has created substantial noise and raised hard criticism of the economic model Peru has followed for more than 20 years, that is a free-market-oriented economy. Surprisingly, those criticisms and attempts to reform are coming from different political parties. Thus, I am more concerned with new bills that try to limit the economic rights of individuals and companies, to impose price controls and to expropriate some industries. In any event, today we have more controls and regulations than we had in the past, and clearly, antitrust control is one of the most important ones. The problem is that when you think about the recovery of M&A activity, you think about big companies holding important market share looking to acquire competitors. It is precisely these kinds of transactions that will be subject next year to a brand new control carried out by an antitrust authority with no relevant experience, no precedents and no duly trained people. This is a real source of concern for buyers and sellers.

Lozano: Sometimes a crisis can push many of our governments into more restrictions, including on foreign direct investment and protectionism.

Delgado: Europe has suddenly approved similar regulation as in seen in the US because of the covid-19 crisis. Now, a foreign investor must get government approval to acquire 10 per cent or more or control of a company in key sectors within the European Union. The definition of key sectors is very broad, and the percentage rule can be interpreted broadly. Because of this crisis, we are seeing more protectionism in the European Union and I think that it's here to stay.

Lozano: We have seen what has happened in the US with CFIUS (the Committee on Foreign Investment in the United States). It has become an important tool for foreign policy. For now, the jurisdiction most affected is China. Jurisdictions in Latin America have not been so hard hit, but because of how interconnected the world is, I am sure that we will all be seeing more cases where we must be concerned with CFIUS reviews.

Galicia: We are experiencing the same in Mexico. The government is trying to control most key activities in the economy. Foreign investment is suffering, especially in the energy sector. This protectionism is making it more difficult to complete transactions, even if they ask for local participation. That takes me back to the joint venture structure, which can offer an alternative for foreign investors navigating an over-regulated and protectionist environment, by partnering with local investors. Also, there is a lack of understanding by some regulators as to how to authorise new digital business platforms. On the one side, you tend to control and limit foreign investment, and on the other side, there is a lack of knowledge and expertise as to how to measure digital platform acquisitions from an antitrust perspective. Our antitrust commission has been working and it's quite sophisticated, but this is part of how we see our M&A transactions evolving.

Robledo: The opportunities in Colombia for M&A are being created by the government. Some regulatory changes have a direct impact on M&A activity. We have a much more lenient antitrust authority right now if you can demonstrate that the combination of businesses brings synergies and cost savings. Right now, you could easily see the two largest airlines in Colombia merging without the antitrust authority necessarily objecting or the largest hotels in Colombia. The Superintendency of industry and commerce and antitrust authorities have a mandate to clear those transactions if they protect jobs or there is a cost-saving or you save the business. Another regulatory change has had an impact. Although we had a developed insolvency regime, one of the things we had not seen was a secondary market for Chapter 11 claims. You didn't see, for instance, banks or financial entities trading those claims in the context of insolvency proceedings in Colombia. We've got a new regime that's been developed in the past three months in which you can bid for the whole business at a certain point during the insolvency proceedings. Now, if banks receive risk bonds, which are the equity or quasi-equity instruments that derived from insolvency proceedings, they can include them in their balance sheet and go out and sell them. Colombia is trying to develop a secondary market for that, and we've seen some interest from local and international players asking whether they should set up a fund to invest in these distressed assets that there are going to be a lot of.

The second way in which I see the government fostering M&A activity is that the government itself is an obliged seller right now. They are going to have to go out and sell assets. It needs to raise around US$9 billion to US$10 billion during 2021. In terms of opportunities, at least for M&A lawyers, it appears that we are going to have some work into the future, at least next year or the year after that. I think that's optimistic and I should say that we should be thankful for being in such a countercyclical business.

Lozano: Private equity funds, venture capital funds, hedge funds - they have the cash. This is not a crisis that stripped out all the liquidity from the investing sector. If you look at how the capital markets have performed, it is almost surprising to see that, in such a huge crisis, the markets continue to skyrocket. There is an appetite for a variety of companies and a variety of jurisdictions. We are pleasantly surprised by the number of Brazilian companies, for example, coming out into the markets, and we have seen that in Colombia and Mexico too. A peculiarity of this crisis is that there is cash in the system. Some sophisticated investors are ready, willing and able to put the money into a transaction. They are looking at targets. There are going to be opportunities never seen as the valuations are depressed and they are going to be looking for sophisticated counsel because those transactions require more structuring. They require experience. They require creativity and so I think it's great value added if we can all focus on helping bring together the capital available from those funds and the companies that desperately need help.

Tornovsky: Investor interest in distressed assets has increased during the crisis. Private equity funds are the first movers and they are the most liquid players in the market. They are going to find good opportunities considering they tend to be quite active in times of crisis. Those that are well funded, meaning the ones that have recently closed a fundraising cycle, tend to benefit because valuations are depressed now. Brazil has good opportunities. We have some advantages: we are a large market, so we have strong potential for growth. We have a very important agribusiness sector, infrastructure investments promoted by the government, private investment in public equity and a favourable exchange rate.

Guerrero: In Chile, we are seeing a lot of private equity firms scouting for assets, some of which we have not seen in the past. There's a lot of activity in the energy and infrastructure sector but also others like agribusiness, food, infrastructure and e-commerce.

Galicia: In the case of Mexico, we have a strong private sector, we have a growing economy and a growing population. We are very close to the US. I see business opportunities in different sectors, a lot of which, like the digital sector, cannot be controlled that easily by the government. We need to be careful as lawyers not to over legalese our documents because of this pandemic. We need to learn how to live in this environment, so we shouldn't overcomplicate agreements in trying to protect clients, because we may limit our clients or their access to finance sources. We need to be practical; we need to be careful and we need to be better lawyers and better business advisers.

Lozano: That's one of the things that I like to repeat often. You need to be useful to your clients, which requires a combination of very high technical training and a lot of working hours with being practical and having a deep understanding of their business.

Tornovsky: We are deal-makers and not deal-breakers. We try to add value.

Part II

Key Players in Latin American M&A

2

The Rise of Multilatinas and the Implications for M&A Deals in the Region and Beyond

Claudia Barrero[1]

Mexico's Grupo Bimbo, Brazil's Vale, Peru's Ajegroup, Colombia's Grupo Sura and Chile's Falabella are all companies that have regional or multinational presence and represent the changing currents in corporate Latin America. Latin American businesses have increasingly developed a global approach and for more than two decades have been buying Latin American assets left aside by investors from Europe and the United States: from retail and industrial businesses to financial institutions.

'Multilatinas' is a term first coined by Álvaro Cuervo-Carruza in 2010 to refer to companies in countries formerly colonised by Spain, Portugal or France that have added-value operations outside their country of origin;[2] they not only export products but have regional operations that represent a significant part of their balance sheet. América Economía, a Latin American business magazine goes further: it includes in its ranking of multilatinas only companies that had sales in 2018 of more than US$230 million and relevant operations in at least two other countries in the region. Based on these criteria, companies that have successfully managed to expand their operations to other countries, such as Leonisa, a Colombian lingerie retailer, Fogo de Chão, a Brazilian steakhouse, Astrid y Gaston, a Peruvian Micheline-rated restaurant, to name only a few, cannot be considered multilatinas, as they have increased their exports within the region but not their presence, whereas companies or groups such as Grupo Bimbo, Cencosud, Falabella, Grupo Gloria, Bancolombia and Gerdau, to name a few, have built added-value operations in several countries throughout the continent.

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2 Cuervo-Cazurra, A, 2010. 'Multilatinas'. *Universia Business Review*, (25), pp. 14-33. Available at: https://www.redalyc.org/pdf/433/43312280002.pdf (Accessed 1 September 2020).

Multilatinas were forged during the economic and political ups-and-downs of the region. In the past, Latin America's economy heavily relied on commodities: since colonial times, countries in the region based their economy on the production and export of natural resources not readily available in the rest of the world, from gold, silver, rubber and oil, to crops like coffee and sugar cane. However, the high price of these commodities and their appeal in the market not only reduced Latin America's incentives to invest in other industries and diversify their risk, but also subjected it to the severe volatility of commodities' cycles. For this reason, during the commodities boom, the economies of many Latin American countries' grew, development projects were undertaken and local companies borrowed from abroad relying on their revenues from high commodities prices in foreign currency; all this coupled with generalised political stability. When the price of commodities fell, economies contracted, companies had a hard time servicing debt, and social and political unrest grew.[3]

By the early 2000s, the price of commodities increased, most countries in the region stabilised, started to grow and incentivise inter-regional trade though the regional trade agreements executed at the end of the twentieth century[4] such as the Andean Community (established in 1969), Mercosur (established in 1991) and the bilateral trade agreements between, among others, the member states of the Pacific Alliance. However, the cyclical nature of commodity trading and its downturn in the middle of the 2010s, beginning with a decline in oil prices, once again affected the region's economy.

Amid that economic turmoil, multilatinas were born. During the lost decade of the 1980s, when the region was undergoing a debt crisis, high inflation rates, closed markets and political instability, family owned and debt-free companies saw an opportunity to invest abroad.[5] Chile was the first country to expand, mainly to Argentina, capitalising on the benefits of high copper prices and available financing at low interest rates. During the *corralito*,[6] Argentina's currency was devaluated and investors fled the country. Chilean companies, willing to assume the risk, swept in and invested heavily, mainly in agribusiness. During this time, Cencosud became one of the first multilatinas,[7] and in the past two decades more companies have become multilatinas owing, among other things, to economic

3 Aguilera, R, Ciravegna, L, Cuervo-Cazurra, A and Gonzalez-Perez, M, 2017. 'Multilatinas and the internationalization of Latin American Firms'. *Journal of World Business*, 52(4), pp. 447-460.

4 Castro Olaya, J, Castro Olaya, J and Jaller Cuéter, I, 2012. 'Internationalization Patterns of Multilatinas'. AD-minister, 21, pp. 33-54. Available at: http://www.scielo.org.co/scielo.php?script=sci_arttext&pid=S1692-02792012000200003&lng=en&nrm=iso (Accessed 1 September 2020), and Aguilera, R, Ciravegna, L, Cuervo-Cazurra, A and Gonzalez-Perez, M, 2017. 'Multilatinas and the internationalization of Latin American Firms'. *Journal of World Business*, 52(4), pp. 447-460.

5 Kandell, J, 2013. 'How Multilatinas Are Taking Over The World'. Institutional Investor. Available at: https://www.institutionalinvestor.com/article/b14zbbzwh2g4fd/how-multilatinas-are-taking-over-the-world (Accessed 1 September 2020).

6 *Corralito* is the informal name given to the measures implemented by the government of Argentina at the end of 2001 to freeze bank deposits in order to avoid large withdrawals of money in the middle of a financial crisis of the country that saw Argentines exchanging pesos to dollars in fear of the devaluation of the local currency.

7 Robles, E, 2013 Latin America: 'The Rise Of The "Multilatinas"'. Site Selection Magazine. Available at: https://siteselection.com/ssinternational/2013/aug/multilatinas.cfm?s=ra#gsc.tab=0 (Accessed 1 September 2020).

reforms that affected their country of origin, the saturation of local markets compounded with the lower amount of domestic opportunities, and the need to diversify the risk portfolio and access new sources of capital.[8]

Outbound M&A by multilatinas

According to S&P Global's deal trends in Latin America as of March 2020, intra-regional deals represented the majority of all deals involving Latin American companies with 55 per cent in 2019 and 54 per cent in 2018. Although there is no unique pattern to the internationalisation of multilatinas, studies have shown that multilatinas are generally family-owned groups or companies with a privately held controlling shareholder or group of shareholders (e.g., Telmex, Camargo Corrêa Cimientos, Aje Group, Cencosud, Grupo Gloria). These organisations are flexible and can take quick decisions. They have a strong and dynamic leadership that can successfully guide the organisation through new challenges and they can offer products or services to low-income markets.[9] For example, Grupo Nutresa, a food processing conglomerate whose main shareholders are Grupo Sura and Grupo Argos, has grown in the past decade, through, among other things, a series of acquisitions, including Cameron's Coffee in 2019, Productos Pasarela in 2018 and fast food chain El Corral in 2015, with international sales in 2019 accounting for US$1.142 million of its sales, in comparison to those of 2016, which represented only US$262 million. These outbound transactions not only increase the regional presence of multilatinas but also their share price. According to a study published by the Boston Consulting Group, the share price of multilatinas that are serial acquirers has appreciated by almost 70 per cent from 2010 to 2018, as a result of their cross-border M&A activity. In this sense, the valuation of multilatinas has been aided significantly by acquisitions throughout the region.

In the past decade, the volume of outbound M&A by multilatinas has been positively affected by divestitures in the region by their European counterparts,[10] particularly in the banking industry, as evidenced by the volume of transactions undertaken by Colombian and Chilean companies, including the following:

- Grupo Sura (Colombia) acquired ING's pension and investment funds assets in Chile, Mexico, Peru, Uruguay and Colombia.
- Grupo Gilinsky (Colombia) acquired HSBC's operations in Colombia, Uruguay and Paraguay.
- Corpbanca (Chile) acquired Grupo Santander's and Helm Bank's operations in Colombia.

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8 Castro Olaya, J, Castro Olaya, J and Jaller Cuéter, I, 2012. 'Internationalization Patterns of Multilatinas'. AD-minister, 21, pp. 33-54. Available at: http://www.scielo.org.co/scielo.php?script=sci_arttext&pid=S1692-02792012000200003&lng=en&nrm=iso. (Accessed 1 September 2020).

9 The Economist Intelligence Unit, 2007. 'Business Intelligence On 205 Economies' - Viewswire. Viewswire.eiu.com. Available at: http://viewswire.eiu.com/index.asp?layout=VWPrintVW3&article_id=882270073&printer=printer. (Accessed 1 September 2020).

10 Casilda, R, 2015. 'The Multilatinas'. [online] Ideas.llorenteycuenca.com. Available at: https://ideas.llorenteycuenca.com/wp-content/uploads/sites/6/2015/06/150611_DI_Special_report_multilatinas_ENG.pdf. (Accessed 1 September 2020.)

- Grupo Aval (Colombia) acquired Banco Centroamericano BAC Credomatic, owned by General Electric; purchased Horizonte from BBVA, Davivienda (Colombia); and expanded in Central America, by purchasing HSBC's assets in Costa Rica, Honduras and El Salvador.

Until a few years back, transactions such as those above were almost only within the realm of North American or European companies. However, the growth of multilatinas, their capacity to adapt and their ability to transform their resources have allowed them to successfully compete regionally.[11] For example, Grupo Nutresa adapted its products to each country in the region to meet the needs and preferences of the local customers;[12] Cemex started to expand in the 1990s throughout the region to hedge against market uncertainties in Mexico, which allowed it to consolidate its cash flows and be less dependent on the Mexican market;[13] and Latam Airlines, which was formed by the merger of TAM and Lan Chile in 2012, allowing it to enter new markets and increase the destinations offered. As the number of M&A transactions in the region increases, so do transactions related to transactional services companies. For example, Credicorp Capital, BTG Pactual and Larrain Vial have expanded their presence and services throughout Latin America owing largely to the investment and trading appetite in the region.

In the future, as multilatinas successfully conquer local markets more companies may seek to expand outside the continent and compete at a global level (becoming a 'Global Latina'), following the steps of Companhia Vale do Rio Doce (Grupo Vale from Brazil) and Grupo Bimbo and Cemex (from Mexico), which expanded their presence outside of Latin America and became industry leaders after international acquisitions.

Divestitures by multilatinas

Over-leveraging, a sustained lack of profitability, adjustment to market conditions, shareholder decisions, an alignment of the core business, regulatory orders, are some of the many reasons a company can decide to partially or fully divest an asset or business unit. In this respect, multilatinas are similar to any other multinational corporation: they buy, build and expand their business, but also need to sell and downscale.

Companies look at divestitures to sharpen their strategic focus on their core business to create more value to shareholders, increase synergies and reduce costs. For example, in a 2018 quarterly earnings call, Avianca announced its decision to focus on its core business of loyalty and cargo operations, and shed partnerships in which it has 50 per cent participation

11 Casilda, R, 2015. 'The Multilatinas'. Ideas.llorenteycuenca.com. Available at: https://ideas.llorenteycuenca.com/wp-content/uploads/sites/6/2015/06/150611_DI_Special_report_multilatinas_ENG.pdf. (Accessed 1 September 2020).

12 De Villa, M, 2016. 'From Multilatina to Global Latina: Unveiling the corporate-level international strategy choices of Grupo Nutresa'. AD-minister, 29, pp. 23-57. Available at: http://www.scielo.org.co/scielo.php?script=sci_arttext&pid=S1692-02792016000200002&lng=en&nrm=iso. (Accessed 1 September 2020.)

13 Casanova, L, Golstein, A, Almeida, A, Fraser, M, Molina, R, Hoeber, H and Arruda, C, 2008. 'From Multilatinas To Global Latinas: The New Latin American Multinationals' (Compilation Case Studies). Publications.iadb.org. Available at: https://publications.iadb.org/publications/english/document/Multilatinas-to-Global-Latinas-The-New-Latin-American-Multinationals.pdf. (Accessed 1 September 2020.)

or where the partner is in charge of managing the business. At that time, the executive vice president of Avianca said:

> *in those businesses, we have small airplanes original carriers flying Cessna Caravans in Central America, Nicaragua and Costa Rica, for instance. So those are the type of investments we are planning now to divest. We're talking to the partner, which is the natural buyer in those cases. And the plan is to try to complete those sales in the first quarter of 2019 basically.*[14]

Similarly, in 2017 Grupo Energía de Bogota (GEB) sold its interest in Grupo Nutresa, Banco Popular, ISA and Promigas to focus on its strategic business, the proceeds of which it invested in its core energy transmission business in Peru, Brazil and Guatemala; and Grupo Argos divested its interests in the port business.

Credit restrictions, economic slowdown and shifts in the global markets have affected the ways in which companies can expand their business. For some, this has caused funding problems; for others it has caused a reduction in returns or both. These factors have in some cases contributed to multilatinas divesting assets to clean their balance sheet, present better ratios, improve financial positions and obtain liquidity. For example, in 2017, JBS, a Brazilian meatpacker and one of the world's largest meat processing companies, announced a sale of assets to raise around USD$6 billion to cut debt and reduce leverage, in the middle of a corruption scandal that plagued its controlling shareholder. More recently, Empresas Públicas de Medellín, a Colombian public utilities company, commenced the sale of its minority interest in ISA and other assets throughout Latin America to finance the construction of Hidroituango, a hydroelectric plant in Colombia. Petrobras, the Brazilian stated-owned oil company, plans to reduce its hefty debt load in the next four years by selling US$20 billion to US$30 billion in assets. Another reason a company such as a multilatina may consider a total or partial divestment is to improve its cash flow or obtain cash in the short term, through the sale of high performing assets or non-strategic minority stakes.

In the future, divestment activity is likely to increase. According to Ernst & Young's 2020 Global Corporate Divestment Study, more companies say that they have held on to assets for too long (72 per cent up from 63 per cent in 2019), with more than 78 per cent of surveyed companies expressing their intent to divest.[15] In all of these divestiture transactions, the concerns of multilatinas are similar to those of any other company that seeks to sell assets. Such concerns include valuation, receiving the majority if not all of the purchase price up front and reducing post-closing financial risk. More importantly, multilatinas are generally concerned with their reputation and relationship with regulators, and how a potential sale and the identity of the purchaser may affect it. Although the company is divesting an asset or a business, that transaction should not affect or have a negative impact on the retained ongoing business.

14 ch-aviation. 2018. 'Avianca To Dispose Of Smaller, Non-Core Carriers'. Available at: https://www.ch-aviation.com/portal/news/72877-avianca-to-dispose-of-smaller-non-core-carriers. (Accessed 1 September 2020.)

15 Mills, R, Kniephoff, C and Murphy, P, 2020. 'How Can Divesting Help Build Resilience And Drive Value Beyond The Crisis?' Ey.com. Available at: https://www.ey.com/en_gl/divestment-study/how-can-divesting-help-build-resilience-and-drive-value-beyond-the-crisis. (Accessed 1 September 2020.)

The covid-19 pandemic is likely to be a factor in the increase in divestitures. Although at this time it is not possible to assess the full impact of the pandemic, it is clear that the crisis has affected global markets and local firm's finances owing to, among others, weaknesses in their supply chains, short-term reduction in customer demand and exposure to foreign exchange. The financial pressure may lead companies in the region to divest assets or business units and multilatinas will likely take advantage of this situation to further expand. Similar to what occurred in the second half of the twentieth century when multilatinas were born, companies that have maintained a solid cash position and are willing to assume the country risk will be able to purchase distressed assets and pursue opportunistic M&A, most likely at a discount.

When considering a divestiture, an issue to be considered early on by a multilatina that consolidates financial statements throughout several jurisdictions is whether the transaction's value can be enhanced by preparing carve-out financial statements for the business or assets being sold. This is not only a strategic decision, but a time-consuming one: the assets, liabilities and operations to be included in such financial statements must be clearly identified, and the document is then generally certified by an independent accounting firm. As the carved-out business or assets are part of a much larger operation, challenges usually arise in preparing the pro-forma financials when the carved-out business or assets are not organised separately within the company or when there are assets, liabilities and operations that are shared with other business units within the same group. Other issues to consider in divestitures are the termination of intercompany agreements and the execution of transitional services agreements to ensure business continuity. Multilatinas usually have an interconnected business with people, processes and systems deeply integrated within their business or services and infrastructure shared across multiple business units. Before executing a transaction, a time-consuming process for any multilatina will be identifying and carving out the pieces, business processes and applications that have to be sold with or separated from the divested asset. For this reason, the need for, and terms of, the termination of any intercompany agreement, and the rendering of any necessary transitional services agreement must be determined in the early stages of the transaction. Transitional services agreement may cause the parties to require a longer than expected pre-closing or integration period and can jeopardise seamless transitions for the business, its customers and employees. It is advisable to carefully consider costs, standards of service and competitive concerns, as well as data-sharing restrictions.

Contractually, multilatinas have the same objectives as any other seller when executing a divestiture, including obtaining certainty of closing. Therefore, all else being equal, a multilatina will look favourably at a purchaser that requires few closing conditions and does not require regulatory approvals, including antitrust clearance. In this sense, potential purchasers that have limited or no presence in the jurisdictions in which the assets or business lines sold are located may be preferred. Similarly, a purchaser will seek to optimise the returns of the business or assets acquired at closing by, among others, ensuring that the seller abides by a post-closing non-compete obligation. For corporate entities, such as multilatinas, such clauses may be acceptable, provided that they do not impose material restrictions on the retained business and that the non-compete is subject to appropriate carve-outs covering potential overlapping activities with existing businesses and potential expansion thereof, as well as expected business plans and growth in other business lines and jurisdictions. However, the most important concern when negotiating a non-compete clause is how to successfully navigate local law restrictions on the enforceability of such clauses. In general, most Latin American jurisdictions accept that for such a clause to be enforceable it must clearly set out the activities to which it applies and have a temporal and geographical limitation that passes a reasonableness test.

Impact of multilatinas entering private auctions on the buy-side

In an M&A auction process, the seller can comprehensively survey the market in search of a buyer and simultaneously compare available offers from all standpoints. In such scenarios multilatinas are just like any other sophisticated bidder. However, as multilatinas already have a presence in several countries throughout the region they possess a significant advantage: they are aware of the risk of the region and are willing to assume it. Knowledge of local authorities, regulatory approvals, currency fluctuation, market and industry risks are some of the issues that any buyer faces when entering a new market and with which they have to become comfortable before executing any transaction, or which are priced by a potential buyer. In this sense, in a private auction the pre-signing transaction timeline for a multilatina can be shorter and the transaction agreements can reflect a greater assumption of pre-closing risk. To the extent the multilatina is already in that market, due diligence timelines can also be reduced.

Another aspect that can differentiate multilatinas from other bidders in a private auction is their corporate governance. In our experience, multilatinas tend to have a more highly developed corporate governance structure than smaller local family-owned companies, because (among other reasons) they have already tapped the capital markets, which helps them to operate in several countries simultaneously as well as to secure financing to execute acquisitions. This improved corporate governance structure does not prevent multilatinas from being agile and flexible when taking strategic decisions. The strong and dynamic leadership of multilatinas is also a success factor when competing for a target in an auction. In fact, the corporate governance structures implemented by multilatinas can also assist them in their growth. In a 2017 interview with the Organisation for Economic Co-operation and Development (OECD), the CEO of Grupo Energía de Bogotá when discussing the company's strategic corporate plan and its medium and long term goals stated that 'this cost-effective growth strategy will be executed though investments in leading regional companies, global strategic partners, the best human talent available and corporate governance standards that abide by OECD guidelines.'[16]

From a contract stand-point, multilatinas do not have any particular requirements or issues that differentiate them from any other multinational buyer. However, as mentioned previously, multilatinas are more adept at managing the risks of investing in Latin America and, because of their presence in the region, can easily review and assess regulatory issues.

16 Oecd.org. 2017. 'Business Brief: Unleashing Latin America'S Energy Potential'. Available at: https://www.oecd.org/colombia/business-brief-unleashing-latin-americas-energy-potential.htm. (Accessed 1 September 2020.)

This is evidenced, for example, in the allocation of antitrust risk. In the transaction agreement, parties typically default to a 'hell or high water' clause, an obligation to divest up to a limit or a reasonable efforts clause without a specific obligation with respect to remedies, with the former being the most seller friendly and the latter the most buyer friendly. Unlike other bidders in a transaction, multilatinas are acquainted and familiar with the authorities and regulatory issues of the region. Therefore, they may be amenable to an equitable distribution of risk between the parties or accept a more seller-friendly provision, provided that its obligations are not excessively burdensome and do not have an economic impact that materially affects the value of the transaction, the business or its current operation.

Merger control challenges for multilatinas

Most Latin American jurisdictions have adopted some type of merger control regime, with the Dominican Republic, Guatemala, Guyana and Bolivia being the notable exceptions, as only certain sectors are regulated and the particular case of Peru, where the implementation of the newly enacted merger control rules has been delayed and is expected shortly. As multilatinas expand throughout the region, the different laws and experience of the regulations in each jurisdiction, and the lack of mandatory cooperation between regulators have added a degree of complexity to transactions in which multilatinas participate.

As the number of cross-border transactions increase throughout the region, so do the number of transactions that have a merger control component in several countries at once. For example, in 2019 Walmart announced its intention to purchase Cornershop, the largest home delivery platform in Mexico and Chile, a transaction that was subject to antitrust approval in both countries and which was opposed by the Mexican antitrust regulator. Recently, in 2020, Cornershop was acquired by Uber Technologies, a transaction also subject to regulatory approval in both countries. Other transactions include:

- the 2014 acquisition by Cosan, a Brazilian conglomerate, of America Latina Logística;
- the acquisition by Itaú of Corpbanca;
- the 2015 acquisition by Empresas Públicas de Medellín of certain assets of Antofagasta; and
- Grupo Exito's acquisition of Libertad, a grocery chain from Argentina, as well as half of Casino Group's interest in Companhia Brasileira de Distribuição.

These are just some examples of transactions that were subject to simultaneous merger control in several jurisdictions. In some of these cases, the formal or informal bilateral cooperation and consultation between competition authorities has proven an important tool, allowing agencies to review the effects and determine remedies, if any, and avoid potential conflicting conclusions or decisions related to competition effects and remedies.[17] However, formal cooperation between authorities is subject to the parties consent, a

17 OECD Secretariat, 2017. Latin American And The Caribbean Competition Forum. 'Session II: Merger Control In Latin America And The Caribbean - Recent Developments And Trends'. Background Paper. OECD. Available at: https://one.oecd.org/document/DAF/COMP/LACF(2017)5/en/pdf. (Accessed 1 September 2020.)

confidentiality waiver or the existence of a bilateral cooperation agreement that fosters the sharing of information.

To move forward from bilateral cooperation agreements, the region's integration initiatives have sought to create a unified process for cross-border mergers and acquisitions. The members of Mercosur advocated for common rules for merger control through the Fortaleza Protocol but the initiative was brief as the protocol was only ratified by two member states and therefore not implemented. Similarly, in the Declaration of Lima, Chile, Colombia and Peru created an informal forum to foster cooperation between each country's competition authorities but the declaration contained no regulation regarding cross-border transactions or other firm obligations. More recently, on 29 April 2020, the members of the Andean Community approved a regulatory framework to formulate and harmonise regulatory policies for merger control. This framework seeks to promote in its member states the formulation and implementation of public policies related to antitrust matters. On a more regional level, differences in the merger control undertaken by each country, the level of development of their laws, restrictions relating to the sharing of information and the lack of mandatory information sharing practices are some of the barriers the region must overcome to implement regional merger control practices. However, this in no way is a material obstacle to the growth and expansion of multilatinas, and in some cases can even prove to be an advantage for them.

Future trends

Multilatinas span many sectors and countries in the region. In a 2018 study, the Boston Consulting Group identified 100 multilatinas from Mexico, Chile, El Salvador, Costa Rica, Panama, Colombia, Peru, Brazil and Argentina and analysed the trends and transformations in the region's economy. Consumer product and service companies increased from 31 per cent to 44 per cent, driven by the expanding middle class; the number of commodities and manufacturing companies fell; and industrial goods companies continued steadily, although notably in greater proportion than those in the S&P 500. Moving forward, these trends are likely to continue: consumer industry and service companies will continue to grow, particularly those related to financial institutions, technology and healthcare. Owing to the decline in the price of commodities, including oil and gas, the number of manufacturing companies will decline. This is in line with S&P Global Market Intelligence September 2019 Deal Trends in Latin America Report,[18] according to which the largest transaction was that related to financial services (Banco Santander's acquisition of the third-party owned equity of its Mexican division), information technology emerged as the primary driver of transaction volume and transactions related to raw materials fell. According to Deloitte's M&A in Latin America report for October 2019,[19] M&A activity in Latin America will also be characterised by the privatisation of state-owned companies in Brazil, the increase

18 S&P Global Market Intelligence, 2019. 'Deal Trends In Latin America'. S&P. Available at: https://www.spglobal.com/marketintelligence/en/documents/deal-trends-latin-america-september-2019.pdf. (Accessed 1 September 2020.)

19 Deloitte. 2019. 'M&A Trends In Latin America'. Available at: https://www2.deloitte.com/global/en/pages/finance/articles/m-and-a-in-latin-america.html. (Accessed 1 September 2020.)

in remittances to Mexico, a competitive plan announced by Peru and the expected rise in private consumption in Colombia. If recent transactions are any indicator, deals related to healthcare, public utilities (particularly energy), and fintech are also likely to increase. Finally, in response to the covid-19 crisis, governments in the region have increased their relief and stimulus spending, which is likely to increase the fiscal deficit. As the deficit mounts, governments will consider a wide range of options, including the privatisation of public companies. For example, the Colombian government has already announced its intention to privatise its assets in the energy sector in an effort to reduce its deficit.

The distribution of multilatinas across countries will also change. Currently, most multilatinas are in Brazil and Mexico, but they are losing ground to new entrants from Chile, Colombia, Argentina and Peru. Although Brazil has a great number of multilatinas, the study by the Boston Consulting Group shows that there was a large drop in the number of companies, mainly due to the recent economic and political instability, whereas Colombia has increased its participation thanks to a financial system that has successfully expanded across Central America.

An interesting trend is the increasing appeal of venture capital, where established firms are collaborating with innovative start-ups in what is called corporate venture capital. According to Global Corporate Venturing Analytics, in 2018 there were 1620 active corporate venture operations, in comparison to the 375 that existed in 2011. The volume of venture capital operations in Latin America is much lower than that in Asia and the United States, but in the first three quarters of 2019 the venture capital activity in the region grew 151.2 per cent from US$700 to US$1,600 million. Multilatinas, such as Grupo Sura, Empresas Públicas de Medellín, Petrobras, Grupo Bimbo and Falabella, have already embarked on corporate venture capital through corporate incubators and accelerators, scouters, venture builders and start-up acquisitions, and are likely to continue investing in all sorts of industries, particularly fintechs and companies that have undergone multiple financing rounds, such as Colombia's Rappi, Mexico's Clip and Brazil's Creditas. These corporate activities, together with government programmes such as Ruta N, StartUp Peru, 500 Startups, Startup Farm, and other external factors have increased venture activity in the region, as evidenced by the number of unicorns that emerged in Latin America in the past decade.[20] As the market matures and funding increases, venture capital deals will increase, start-ups will consolidate and become the future multilatinas. Japanese conglomerate Softbank announced the creation of a US$5 billion investment fund for Latin America and has already invested US$1 billion in Rappi, a Colombian unicorn.[21]

Economic integration mechanisms in Latin America

The opportunities presented by regional trade agreements created incentives for multilatinas to expand rapidly. In the future, the growth and development of existing multilatinas, as well as the creation of new ones that are able to compete on a regional scale,

20 A 'unicorn' is a start-up company valued at over US$1 million. Latin America's unicorns include Rappi, 99, Nubank, Ascenty, Gympass, Prisma Medios de Pago, Softek and QuintoAndar.

21 See Chapter 4, for insight into venture capital deal-making in the region.

will be determined by multiple factors, among them, the advancement in current integration processes, particularly the Pacific Alliance, and the number of countries that adhere to them, which can create investment opportunities and promote the expansion of companies.

Concern with promoting regional integration has always been the intent of policy makers in the past decades and there are several projects that seek regional integration, such as Mercosur CAN, CARICOM, UNASUR, SICA, ALBA, the Pacific Alliance, CELAC, among others, but an economic integration such as that achieved by NAFTA, the European Union and ASEAN is still not within reach. In light of this, some multilatinas are expanding within subregion free-trade areas, as defined by the Mercosur Pact (Brazil, Argentina, Uruguay and Paraguay) or the Pacific Alliance (Chile, Colombia, Mexico and Peru), both of which present a turning point in Latin America, with former Argentinian President Mauricio Macri openly finding ways to marry Mercosur and the Pacific Alliance.[22] The next steps for the region in terms of economic integration will be addressing issues pertaining to pension funds, bank accounts, multi-jurisdictional financing of development projects, obstacles in capital flows and export diversification, with the largest gains in integration likely to come from financial sector integration: if the financial markets of Colombia, Peru and Chile merge, and afterwards combine with a larger market such as Brazil or Mexico, an array of growth opportunities could be created by diversifying investment and liquidity channels.[23]

Multilatinas will likely closely monitor any developments in the economic integration of the region. As legal and regulatory uncertainty affect investment decisions and valuations, any step forward in this regard will promote intra-regional M&A activity. Regional alliances will also want to undertake commercial agreements with other regions. For example, the Pacific Alliance has expressed its desire to finalise negotiations with Australia, Canada, New Zealand and Singapore, which can present expansion opportunities for multilatinas outside the region.

Regulatory matters involving publicly traded multilatinas

In order to become a multilatina, capital is essential. To this end, a number of multilatinas have looked towards the capital markets for liquidity. This is evidenced by the fact that of the 30 largest multilatinas in 2019, as ranked by *America Economía*, only seven are privately held in their entirety. Once listed, companies can raise additional capital through the issuance of shares and are more likely to be able to execute stock for stock transactions, allowing them to expand without significantly affecting their balance sheet. For example, between 2015 and 2017, Grupo Argos executed a two-part acquisition of Odinsa, a company dedicated to the structuring, promotion, management and development of infrastructure projects in Colombia, which was partly paid in stock. By using its own equity, Grupo Argos minimised cash disbursements and limited the impact of the transaction on the company's balance sheet. Listed companies also become subject to greater scrutiny and more regulation and

22 Merco Press. South Atlantic News Agency, 2016. Available at: https://en.mercopress.com/2016/08/18/macri-after-full-integration-of-mercosur-with-the-pacific-alliance. (Accessed 1 September 2020.)

23 Marczak, J and George, S, 2016. 'Pacific Alliance 2.0 Next Steps In Integration'. Atlantic Council Adriane Arsht Latin America Center, Bertelsmann Foundation. Available at: https://publications.atlanticcouncil.org/pacific-alliance/AC_PA_en.pdf. (Accessed 1 September 2020.)

therefore must adopt a sophisticated corporate governance structure. Such a corporate governance structure usually engenders the trust of investors, the public and financial institutions, increasing their profile, and more importantly, providing them more access to local and international financing sources.

Most Latin American countries have adopted securities regulations that, in the context of a purchase by a listed company, can affect the disclosure of the transaction, and in the case of the sale of a listed company can affect the due diligence, disclosure and structure of a transaction. Specifically, securities regulations in the region provide disclosure obligations in light of which parties must provide exceptions to non-disclosure and confidentiality agreements and public announcement clauses that allow the listed party to make public disclosures and respond to inquiries by a competent authority. When executing transactions with respect to listed stock, securities regulations usually include some type of mandatory tender offer rule once a certain threshold or triggering event is met. These requirements present challenges that must be addressed by the parties in the early stages of the transaction, but in no way limit the ability of multilatinas to undertake transactions and to be active participants in the M&A field.

3

Private Equity Funds and Institutional Investors in M&A

Maurizio Levi-Minzi, Peter A Furci, Andrew M Levine and Jonathan Adler[1]

Private equity funds and institutional investors have become increasingly prominent in Latin American M&A activity. From 2009 to 2019, the portion of annual M&A activity in Latin America involving capital invested by private equity funds and institutional investors has grown from approximately 2.5 per cent to 25.8 per cent.[2] This significant increase is fuelled in part by factors that have propelled the global growth of private equity. But this shift also reflects the increasing acceptance in Latin America that private equity can accelerate the growth of businesses with expansion potential and, in the case of infrastructure, provide essential long-term funding. More broadly, private equity funds and institutional investors offer: much needed capital to finance promising enterprises; business practices and models that enable local companies to leverage strategies already road tested in other markets; and advanced corporate governance practices that strengthen the transparency and durability of local enterprises.

The impressive market penetration that private equity funds and institutional investors have achieved in the region is even more remarkable considering the many economic and legal obstacles they face in Latin America. Because of these obstacles, private equity funds and institutional investors have had to tailor to Latin America their traditional approach of looking for undervalued businesses that can deliver steady cash flows, if not spectacular growth. These local circumstances, which we will discuss next, have shaped an approach to private equity deal-making that focuses on identifying targets with significant growth potential and then negotiating contractual terms calibrated to provide some protection against the many unexpected developments that seem to occur frequently. As explored in the balance of the chapter, this approach is reflected in: the sectors that private equity funds and institutional investors target; the emphasis on flexible contractual protections that

1 Maurizio Levi-Minzi, Peter A Furci, Andrew M Levine and Jonathan Adler are partners at Debevoise & Plimpton LLP.

2 Based on data supplied by Pitchbook, https://pitchbook.com.

allow private equity and institutional investors to 'roll with the punches'; and the valuation and exit approaches used by private equity and institutional investors in Latin America.

Overcoming intrinsic challenges

The most noteworthy economic challenge that foreign private equity and institutional investors confront in Latin America is the dramatic volatility of many local currencies. For example, over the past two decades, since the adoption of the floating exchange rate regime, the currencies of the two most important economies in the region (Brazil and Mexico) have fluctuated in a manner that has impacted the investment process in various ways.[3] Exchange rate volatility makes valuations at entry more difficult given uncertainties in valuing future cash flows. It also creates the need to allocate exchange rate volatility risk between signing and closing, which could take up to several months depending on the closing clearances required. Exchange rate volatility also can impede an exit where a seller needs to monetise an investment during a period of local currency devaluation. Since hedging extremely volatile currencies is not economically viable, investments in Latin America by foreign private equity funds and institutional investors must be made in spite of foreign exchange risks. However, this risk is not necessarily a concern for domestic private equity funds and institutional investors funded primarily in local currencies and that likewise report their results in local currencies. As domestic private equity funds and institutional investors grow, we would expect that they will be able to leverage their 'currency advantage' in auctions.

The second most significant economic obstacle to private equity investments in Latin America – which domestic players share with their foreign counterparts – is the limited availability and cost of leverage as a key private equity strategy. For reasons including the limited availability of credit to finance buyouts and minority investments, as well as competition from cheaper sources of financing including from state-owned financial institutions, private equity investments in Latin America rarely involve additional leverage as a key strategy to boost returns.

In addition to foreign-exchange risk and limitations in available leverage, private equity funds and institutional investors in Latin America also must contend with:

- corrupt practices that have appeared to be endemic in some geographies and industries;
- the political volatility of most countries in the region;
- the vulnerability of commodity-driven economies to cyclical external shocks coming from China, the United States or Europe;
- in certain jurisdictions, concerns about 'piercing the veil' and directors' exposure to personal liability;
- transparency issues in the due diligence process;[4]
- markets in which there are few (if any) generally accepted and publicly shared contractual terms for M&A deals, resulting in lengthier negotiations requiring more commitment of the investment team's time;

3 International Monetary Fund, 'Foreign Exchange Intervention in Inflation Targeters in Latin America', https://www.elibrary.imf.org/doc .

4 See Chapters 5 and 12 of this guide.

- tax complexities;
- burdensome labour practices; and
- delayed exits due to currency, economic or political factors.

Notwithstanding these challenges, private equity funds and institutional investors have achieved important successes in Latin America. They have done so by deploying mitigating strategies aimed at: (1) concentrating on robust and resilient sectors of the economy expected to grow over time, such as infrastructure, technology, consumer products and life sciences; (2) proactively addressing difficulties through pricing and contractual terms; and (3) leveraging their operating expertise to improve both the bottom line and overall performance of the companies in which they invest. These strategic imperatives have been key factors in shaping private equity investments in the region. Indeed, the many past successes of private equity investments in Latin America demonstrate that savvy and astute deal-makers are aware of these risks and have developed sophisticated strategies to mitigate them.

While the pandemic's impact on the economies of the region will pose additional novel challenges,[5] private equity funds and institutional investors appear to be well prepared to ride out even this unique storm. Past experiences have honed their skills at managing businesses through unexpected developments. In this regard, grappling with tough scenarios has been and probably will continue to be normal ordinary course of business for private funds and institutional investors active in Latin America. As discussed below, the business and legal approaches that private equity investors have developed for this region are designed expressly to navigate through radically uncertain scenarios that are hard to quantify and therefore price.[6]

Mitigating risks through contractual rights

A critical element of this risk mitigation involves negotiating contractual rights that support an investment thesis and address the idiosyncratic challenges faced in Latin America. In our experience, particularly in the case of acquiring minority stakes, the most significant such contractual protection relates to the target's business plan and deviations from such plan. Given that management of unexpected developments is a principal concern of private equity and institutional investors in Latin America, it can be safely assumed that any plan beats no plan[7] when carrying out a successful acquisition.

Developing with the controlling shareholder a shared business strategy is often the first order of business in protecting the investment thesis of a private equity investment. Typically, private equity and institutional investors begin developing an economic narrative for their proposed investment during the due diligence exercise. In this phase of trying to understand 'what is going on here,' investors often come up with approaches to encourage

5 See Chapter 1 of this guide.

6 Kay, John & King, Mervyn, *Radical Uncertainty: Decision-Making Beyond the Numbers* (2020).

7 Geithner, Timothy F, *Stress Test: Reflections on Financial Crises* (2015).

and upgrade winning strategies while trying to discourage and control business approaches perceived as counterproductive.

Many businesses in Latin America, particularly family-run businesses, are still used to operating in fairly unstructured and informal manners.[8] For this reason, the introduction of formal planning and, even more importantly, the acceptance by the target's management of processes and procedures calibrated to ensure adhesion to a business plan can sometimes be challenging. In particular, they may require behavioural changes that the controlling shareholder and management resist. This is one of the principal reasons why many of the international private equity and institutional investors that have been most successful in the region have a local team capable of bridging the gap between business cultures. A local team can be critical inasmuch as 'boots on the ground' help overcome deviations from the plan and the nearly inevitable mid-course adjustments.

In order to protect a proposed investment's economic rationale, other significant factors include:

- ensuring that the investor gains a seat on the target's board and sometimes a senior position (or more than one) on the executive team;
- obtaining a sensible package of veto rights over the most material decisions of target, such as fundamental changes in the scope of its business or business plan, new acquisitions, large capital investments, changes in dividend policy and material borrowings; and
- negotiating a fulsome set of information rights that will enable the investor to adequately and timely monitor the performance of the target and fulfil its reporting obligations in compliance with fund documents and regulatory requirements.

Although the inclusion of such contractual provisions is critically important, building a close relationship with the controlling shareholder and the target's management is perhaps even more important, as that is the principal path to ensure that the private equity investor can influence effectively the implementation of the agreed business plan.

Compliance considerations also feature prominently in formulating appropriate minority protection rights. We live in an era of aggressive anti-corruption enforcement, including in Latin America, and compliance violations can impact materially the ultimate valuation of an investment. It is therefore imperative that the package of covenants protecting the economic deal of the investor includes the commitment by the target and controlling shareholder to comply with relevant laws and to implement or otherwise maintain a risk-based compliance program and system of adequate internal controls. Perhaps most importantly, a minority investor must ensure that appropriate steps are taken to remediate any wrongdoing or deficiencies uncovered during due diligence or otherwise identified during the course of the investment. This may include a specific covenant by the target and controlling shareholder, appropriate monitoring by the investor and sometimes review by external advisers.

8 See Chapter 5 of this guide.

Private equity and institutional investors in Latin America also are increasingly focused on broader environmental, social and governance (ESG) considerations in negotiating minority protection rights, at least partly under the influence of their limited partners and public opinion. To ensure that investments are environmentally sustainable and have a positive social impact, investors often seek to promote portfolio companies' adoption of more advanced corporate governance practices. This is consistent with the idea that invested companies may benefit from experiences and know-how developed in other markets.

Mitigating strategies through transfer restrictions

Private equity funds and institutional investors typically seek to negotiate transfer restrictions that may include:

- a lockup for some limited period following the investment;
- rights of first offer or rights of first refusal depending on the investment and the controlling shareholder's profile;
- covenants not to transfer shares to sanctioned persons or competitors; and
- tag-along rights that may result in having to accept being subject to drag-along rights.

Investors in Latin America seek such restrictions for the usual reasons that motivate investors in other markets, principally ensuring that new shareholders are reputable and preferably not competitors. But certain reasons are specific to circumstances in Latin America. As discussed above, the timing of an exit is often complicated by currency volatility and the long stretches of recessions experienced by these markets. For this reason, private equity investors often are extremely leery of having additional investment partners, particularly local investors with different priorities and investment horizons. Finally, private equity investors use transfer restrictions as a mechanism to screen out potential partners that could be tainted by corruption or other compliance misdeeds.

Valuation challenges and competition with strategic players

For various reasons, valuing a target in Latin America is often significantly more challenging than valuing a similar business in a developed market. To begin, public data on comparable companies is typically unavailable owing to the shallowness of the local capital markets. As a result, private equity players at times resort to using developed-market multiples for companies in the same industries and then, somewhat arbitrarily, adjusting these multiples for 'local risk'.

Valuing Latin American targets by modelling discounted cash flows is just as fraught with difficulties. The robustness and reliability of the financial information available on targets remains less than perfect as many family-controlled companies operate in an informal manner. Developing projections based on weak historical information is a bit of an exercise in educated guesswork. The cycles of booms and busts that have characterised the macroeconomic picture of Latin American countries further complicates this analysis, including determination of an appropriate discount rate. To address these issues, some private equity investors look to invest in infrastructure targets that may offer the stability and certainty of contracted revenues or companies in the technology sector that are asset-light and tend to generate higher rates of growth.

It is not unusual for private equity funds and institutional investors in Latin America to find themselves in heated competitive auctions that involve local and international strategic players. This can turn out to be challenging for private equity funds and institutional investors because strategic players may be prepared to pay generously for assets that offer them unique synergies or allow them to defend market positions.

Talent challenges in buyouts

Private equity funds and institutional investors focusing on buyouts rather than partial acquisitions previously have faced talent challenges. While private equity funds in more developed markets have recruited managerial talent kept on standby and poised to be deployed in portfolio companies, this practice has not yet taken hold in Latin America.

As a result, for a private equity fund to launch a buyout with a view toward improving a target's business performance, the fund must engage in the ad hoc recruitment of superior new management. Although this has been difficult in the past, the breadth and strength of the new business class in Latin America could bring about a change. Domestic private equity funds and institutional investors and their foreign counterparts with local offices may be best positioned to tap into the local talent pool and engage in a larger number of buyouts in the future.

Pooling with other investors

To date in Latin America, there have been few instances in which private equity funds have combined with strategic investors to pursue acquisitions together.[9] It has happened where the strategic investor brought special industry expertise relevant to the proposed transaction. More of these transactions seem likely in the future.

'Club deals' involving multiple private equity investors are also relatively rare in Latin America, except for very large privatisations of infrastructure assets.[10] When these transactions involve investors based in and out of the region, participants need to find a consortium equilibrium that reconciles financial objectives and contractual priorities, which often are not perfectly aligned. Since large infrastructure projects are likely to figure prominently in future M&A activity in Latin America, a growing number of club deals likely will occur, including participants that over time will develop a shared approach to such transactions.

9 One recent successful case was the joint bid by Engie and Caisse de dépôt et placement du Québec (CDPQ) for Petrobras's stake in the Brazilian natural gas pipeline company Transportadora Associada de Gás (TAG) (source: 'Engie-CDPQ Consortium concludes purchase of Petrobras' 10 per cent stake in TAG', Lavca (7 July 2020), https://lavca.org/2020/07/20/engie-cdpq-consortium-concludes-purchase-of-petrobras-10-stake-in-tag).

10 One example is the acquisition of 40 per cent of the shares of Mexican infrastructure operator Impulsora del Desarrollo y el Empleo en América Latina (IDEAL) by Canada Pension Plan Investment Board (CPPIB) and Ontario Teachers' Pension Plan Board (OTPP) (source: 'CPPIB and OTPP finalize purchase of 40 per cent stake in Mexican infrastructure operator IDEAL', Lavca (16 April 2020), https://lavca.org/2020/04/16/cppib-and-otpp-finalize-purchase-of-40-stake-in-mexican-infrastructure-operator-ideal).

On the other hand, co-investments between foreign private equity funds and sovereign wealth funds have been pursued with increased frequency and with some success in recent years.[11] Typically, one of the thorniest issues posed by these combinations flows from differences in investment horizons and, consequently, misaligned preferences regarding liquidity and exit arrangements. The market has developed some creative solutions to address this misalignment involving separate windows for exit. The important takeaway is that sovereign wealth funds have greater flexibility in investing in Latin America, because the limited windows for exit available in these markets typically matter less to such investors.

Tax considerations

Although a detailed discussion of the complex tax issues that private equity and institutional investors confront in Latin America is beyond the scope of this chapter, it is nevertheless worth reviewing some of the key considerations.

Tax first arises during the due diligence process, as an investor assesses the target's historic tax compliance and material exposures. In many countries in Latin America, of which Brazil is perhaps the most notable example, ongoing tax disputes between companies and revenue authorities are extremely common. An investor 'learning the ropes' in the region may be surprised, or dismayed, at the extent of a potential target's tax disputes, as compared to other regions. In purchases from creditworthy strategic sellers, historic exposures often can be addressed through a pre-closing tax indemnity. However, many deals involve purchases from a founding family group, or from a financially distressed seller, where obtaining such an indemnity can be more challenging and potentially have more limited value.[12] In these cases, it is important to look beyond the nominal exposures to understand context. To what extent do the exposures indicate fundamental compliance issues or unduly aggressive tax planning? Or are they common audit disputes that similarly situated companies are likely to face? Private equity and institutional investors need high quality advisers who can not just identify and quantify exposures, but can assess commercially whether the risks are reasonable or justify greater contractual or other protections.

The second key area involving tax is investment structuring. As most private equity and institutional players in the region are investing cross-border, their objectives often include reducing the local taxes payable on dividends and exit gains, as local taxes reduce returns and are unlikely to be of use as a credit to the majority of fund investors that are not taxpayers. Across the region, different structures have been used that vary from country to country.

Of particular note, Brazil has a private-equity tax regime (the FIP regime) that enables offshore investors to avoid tax on exit gains so long as certain requirements are met. In recent years, the Brazilian tax authorities have challenged the eligibility of non-resident

11 By way of example, Brookfield Infrastructure acquired a controlling stake in Nova Transportadora do Sudeste S.A. in consortium with CIC Capital Corporation, GIC Private Limited and others. 'Brookfield Infrastructure Announces Closing of South American Natural Gas Transmission Utility Transaction', Brookfield (4 April 2017), https://bip.brookfield.com/press-releases/2017/04-04-2017-230208159.

12 See Chapter 14 of this guide.

investors to the FIP exemption, including by arguing that the jurisdiction of the beneficial owners of such investors (and not just that of the investing vehicles themselves) should be considered in assessing whether the domicile requirement is met. In December 2019, the Brazilian tax authorities issued an acknowledgement that the investing vehicles' jurisdiction is the one that should matter, except for a sham or fraudulent circumstances.[13] Although this has been viewed as a positive development, it appears that tax authorities (as well as the local FIP administrators responsible for ensuring payment of withholding taxes by FIPs) have continued to scrutinise indirect beneficial ownership. As a result, many private equity sponsors investing in Brazil have scrambled to restructure offshore fund structures from the Cayman Islands or other blacklisted jurisdictions. These restructurings raise significant legal, tax, administrative and potentially investor relations issues that require meaningful time and attention, and should be addressed well ahead of portfolio company exits.

In most other countries, investors may utilise a holding company organised in a country having a tax treaty with the local country (Spain, Netherlands and Luxembourg are among the most common) to reduce or eliminate exit taxes. Some countries do not have a treaty network; in these cases, the future tax liability must be factored into the returns for purposes of the investment thesis. Here again, quality advice is essential, as the tax laws (and the enforcement posture) of Latin American countries frequently change, and structures that worked for previous investments may no longer work in the future.

Exits

The challenges discussed thus far are serious, but can pale in comparison with the issues that private equity funds and institutional investors face when it comes to finding a path to monetise and exit their original investment.

Private equity investors in developed markets typically exit their investments in one of five ways (or, more rarely, a combination of these approaches):

- perhaps most commonly, a public offer of the portfolio company shares in which the investor sells its shares immediately or over time;
- next most popular, a trade sale or an acquisition by a suitable strategic company interested in acquiring a complementary business;
- a secondary sale to another private equity investor (which may become appealing if the original investor needs to monetise the investment while the business continues to require funding);
- a repurchase of the private equity stake by the original shareholders or management; or
- the least successful approach, a liquidation that happens if the investment fails.[14]

13 The rule is available at: http://normas.receita.fazenda.gov.br/sijut2consulta/link.action?idAto=105652&visao=compilado.

14 Alternatively, a distressed M&A transaction may be attempted. See Chapter 8 of this guide.

In Latin America, each of the foregoing successful exit paths presents some 'bumps in the road'. Public offerings of shares in Latin American companies are challenging because local capital markets are not deep and the window for launching them opens only infrequently and often closes fast. When the markets finally open (as, for example, they seemed to be in Brazil during the third quarter of 2020), there is a mad scramble to list and a strong sense that it is crucial not to miss this unique opportunity. Of course, the problem is that the 'feast or famine' character of local markets makes it difficult to predict upfront, at the time of investment, whether an exit through an IPO is a likely option. The feasibility of a public offering of the shares of a Latin American company in New York or in another international market also is uncertain due to the volatility of the currencies involved. Private equity investors need to consider whether there will be appetite for this additional risk and how this risk will affect the exit price.

Trade sales are a great option for private equity in Latin America if a strategic with deep pockets can be identified.[15] While there are a few examples of successful trade sales, this strategy seems to be less common than in developed markets. Similarly, the market for secondary sales of portfolio companies to other private equity investors appears to be growing in Latin America. The most likely buyers of these private equity stakes, at least in the infrastructure sector, seem to be sovereign wealth funds.[16] Finally, we have not observed too many instances in which a successful exit was achieved through a repurchase of the portfolio company stake by the original shareholder.

On balance, private equity players in Latin America have reasons to hope that the future of exits may be characterised by increased liquidity as the local capital markets should develop and deepen to match the size and strength of the continent's economies.

Conclusion

When we wrote this chapter in the summer of 2020, the future looked extremely uncertain due to the pandemic and its economic impact. Many observers are currently quite bearish on the near-term outlook for the economies of Latin America. Perhaps they are right; perhaps they are not.

Despite not possessing a crystal ball, we remain optimistic for four main reasons about the long-term future of private equity and institutional investors in Latin America.

First, we would expect that, as the local economies mature, the size of the deals will grow and the capital invested by private equity and institutional investors in Latin America will grow significantly.

Second, in time, the local capital markets in Latin America should grow and mature to provide a better path to exit private equity investments.

15 In a recent example, Advent International agreed to sell its stake in Brazil-based digital investment platform Easynvest to Brazilian fintech Nubank. 'Advent International agrees to sell its stake in Easynvest and become an investor in Nubank', https:/adventinternational.com.

16 'Sovereign Funds: Latin America's Hidden Investment Potential', World Crunch (9 May 2019), https://worldcrunch.com/business-finance/sovereign-funds-latin-america39s-hidden-investment-potential.

Third, private equity funds worldwide have plenty of cash ready to invest and will be looking for opportunities, including in Latin America.

And last, we believe that private equity funds and institutional investors in Latin America have developed the tools and skills necessary to operate in a highly uncertain environment, as discussed in this chapter.

There inevitably may be some issues with many investment targets in Latin America, but there are also terrific growth opportunities. As Leonard Cohen once wrote: ‘There is a crack in everything; that’s how the light gets in.’

4

Venture Capital Investments: Key terms and Avoiding the Battle of the Forms

Jared Roscoe and Stephen Pelliccia[1]

Venture capital (VC), seed equity and growth capital investing are terms used interchangeably to refer to investments in start-ups or early-stage businesses that usually entail significant risk compensated by a high potential for growth and profit. Professional venture capital investors typically contribute their know-how and expertise to their targets in addition to their capital. Further, it is often expected that there will be subsequent rounds of investments by the same VC investor or from additional sources. VC has provided much needed capital and expertise to business entrepreneurs in Latin America in recent years, and we are confident that it will play an increasing role in the growth and expansion of companies in more business sectors and countries in the region.

The Unite States and other sophisticated markets have enjoyed a long history of VC financings, and customary practices have been developed that are specific to deal-making in that space. Some practices are analogous to traditional M&A partial acquisition transactions covered elsewhere in this Guide, but some practitioners follow the National Venture Capital Association (NVCA) form documents. Those documents include:

- investors' rights agreement;
- voting agreement;
- right of first refusal (ROFR) and co-sale agreement;
- certificate of incorporation or memorandum and articles; and
- management rights letters and regulatory compliance letters.[2]

1 Jared Roscoe is deputy general counsel and senior director and Stephen Pelliccia is director and senior counsel at SoftBank Group International.

2 The NVCA form documents were created in 2003 by a group of in-house counsel and private practitioners in the venture capital space and posted to the NVCA website. Since then, the forms have been periodically updated by a

It is natural then that, as Latin American markets see increased VC investments, transaction parties and their counsel need to assess and implement the appropriate way to document these transactions, taking into consideration local practices and the extent to which US practices should be imported and tailored. It is typical for the investor making the largest investment in the company in the financing round – the lead investor – to negotiate with the company the documentation to which all investors participating in the round will subscribe.

In this chapter, we will analyse the key terms of the NVCA transaction agreements, the involvement and commitment of the target in the transaction agreements, and compare and contrast the complex suite of documents advocated by the NVCA, to the use of a tailored approach through one comprehensive shareholders' agreement signed by all shareholders of the target and the target itself. Given the increased presence of large international VC investors in the region who are comfortable with the NVCA forms, an understanding of their key concepts and structures is particularly important for Latin American start-ups and those seeking to become the next Latin American unicorn.

Investors' rights agreement

The investors' rights agreement, frequently referred to as an IRA, is arguably the most important of the NVCA agreements owing to the breadth of matters it covers. The IRA typically establishes registration rights, information rights, the right to a board observer, contractual pre-emptive rights, matters requiring board approval and director veto rights, and, to the extent not covered in a regulatory compliance side letter, compliance provisions and other ongoing covenants of a company. The IRA is typically executed by the company, holders of preferred stock (typically the VC investors), defined as 'investors', and founders, defined as 'key holders', which are collectively referred to in the IRA as 'holders'.

Registration rights make up the majority of the text of the IRA, and while the details of registration rights are beyond the scope of this article, the IRA typically includes:

- S-1/F-1 demand registration rights, for an investor to force a company to consummate an initial public offering in the US;
- Form S-3/F-3 demand registration rights for companies that are eligible to use such forms; and
- 'piggyback' registration rights that allow an investor to cause a company to include shares held by such investor in a registration being carried out by the company.

VC financings in Latin America may not give investors the right to force an IPO of the company in the region. Local capital markets are not typically seen as an attractive exit option for VC investors because of their lower levels of liquidity and the higher concentration of growth stage companies listed on US exchanges. Legal hurdles and less familiarity with the process of going public in certain local markets further decrease the attractiveness. Consequently, registration rights in Latin American VC financings are often not heavily negotiated departures from the IRA form.

working group convened by the NVCA, and additional forms have been created to address particular situations or industries. See https://nvca.org/model-legal-documents/ for the current collection of NVCA form documents.

When negotiating registration rights, it is important to ensure early on that these rights will be available at the corporate level and jurisdiction, including through a holding structure, that allow for the most efficient exit from a tax perspective and provide potential purchasers comfort from a governance perspective, in each case, to ensure marketability for a successful public offering. For example, registration rights that only apply to a Brazilian operating company but not to its Delaware or Cayman parent would severely restrict the effectiveness of this type of exit for an investor. Naturally, the extent to which a target will reach the performance metrics required to launch a successful IPO on the US markets is itself a case-by-case analysis and by no means a certain outcome. That fact alone often requires significant departure from the NVCA form. Relatedly, investing through a vehicle established under the law of an investor-friendly jurisdiction can mean that registration and other important rights will be enforceable under local law at the holding company level.[3]

Information and observer rights are not typically heavily negotiated but there are some key provisions to keep in mind. In the NVCA form, an additional classification of investor, a 'major investor', joins the fray of 'investors', 'key holders' and 'holders'. The 'major investor' term sets forth a share ownership threshold over which shareholders are entitled to receive information rights. The threshold to receive information rights is frequently set at a percentage that would allow the smallest preferred holder or institutional investor to not be excluded; however, 5 per cent is typical. One of the key components of most management rights letters provides certain investors with a separate contractual right to continue receiving information rights even if they fall below this threshold in the IRA and cease to be a major investor. A major investor may also lose its information rights if it is determined to be a competitor by the board of directors of the company. A more investor-friendly approach would be to carefully define competitor to prevent these rights from being capriciously removed or to exclude specified investors from the definition of competitor. This is particularly important given the rise of pan-Latin American companies that grow after the time of a major investor's initial investment and negotiation of the IRA to cover a much wider geographic scope, and potentially come into competition with other portfolio companies of that major investor. This could put the major investor in a position where a company's expansion into a new territory could trigger the 'competitor' determination and all information (and potentially other) rights would disappear.

One of the most common and most important provisions in the IRA is the pre-emptive right, referred to in the NVCA agreements as a right of first offer on future stock issuances, and informally as 'pro rata rights'. This right allows shareholders entitled to it to participate in future equity rounds in proportion to their pre-round equity ownership, and thus provide an opportunity to avoid dilution by investing more into the company. In the NVCA form, pre-emptive rights are only extended to major investors, using the same definition and sunset threshold as used for the granting of information rights. Pre-emptive rights are typically not granted to all shareholders, to limit the burden on companies raising future equity rounds, running the process required by pre-emptive rights can entail a considerable administrative burden for the company, especially when the ownership of the company

3 See the related discussion in 'Charter' below.

is held by a large number of investors from previous rounds. Counsel should be aware that pre-emptive rights may be mandatory under local law or provided under default rules, depending on the jurisdiction and the type of legal entity. For example, under the law of most Latin American countries, including Brazil, pre-emptive rights are granted under law for shareholders of certain types of local issuers, so as a matter of local practice they are often expected and extended to more shareholders than just the major investors, even if the issuer in question is not incorporated under local law. In addition, institutional investors making bets on early stage companies may ask for enhanced pro rata rights that allow the investor to take a disproportionately large percentage of the next equity round. This can be viewed by founders as a show of faith by an institutional investor or can be resisted by founders who do not wish to be wedded to the same investor in future rounds.

Finally, the IRA can also contain a variety of forward-looking covenants that restrict how a company may operate. These provisions can be as straightforward – though commercially sensitive – as veto rights for a particular investor's appointee to the board or all directors appointed by holders of preferred stock. But they can also include remedial provisions arising out of due diligence and tax compliance covenants including regarding corporate anti-deferral tax regimes (including, in the case of VC investors with a US nexus, regarding controlled foreign corporations (CFCs) and passive foreign investment companies (PFICs)) and – if not included in a stand-alone regulatory compliance letter – covenants to comply with anti-corruption laws, anti-money laundering laws and, increasingly frequent, data privacy and cybersecurity laws.

Voting agreement

The voting agreement NVCA form binds the preferred holders, referred to as 'investors', and holders of significant portions of common stock, typically the founders and occasionally other key employees or early investors, referred to as 'key holders', to vote their shares in unison for the election of directors nominated by a specific party and in favour of a sale of the company meeting certain criteria (i.e., a drag-along). When an investor is granted the right to appoint a director to the board of a company, the mechanism by which this is accomplished is a covenant from the other shareholders to vote their shares in favour of appointment (and removal) as instructed by the investor holding this right. The total size of the board and other significant rights related to the board and its directors, such as the list of specific decisions that require approval by the majority of the board, is not necessarily established in the voting agreement but rather in the relevant organisational documents (memorandum and articles, by-laws, *estatutos*, etc.). As such, the voting agreement will frequently not give a comprehensive picture of board composition or board rights. As many important board (and shareholder) rights are established under or informed by local law, investors have another reason to consider carefully the jurisdiction of the entity in which they are investing, as the ability to successfully enforce those rights under local law is an important protection for investors (for more on this point, see 'Charter' below). In addition to an investor's right to appoint a director, investors should carefully consider the rights founders have to appoint directors, particularly when such founder appointees represent a larger portion of the board than is supported by the founders' collective equity interest in the company. The parties will seek to balance the founders' desire to maintain control over the company they have created with the investors' desire to institutionalise the company as it grows with strong governance, including through the appointment of independent directors. Furthermore, local corporate governance practices may come into conflict with international investors' expectations.

The drag-along right is of crucial importance to an investor as it is the only provision in the NVCA voting agreement form pursuant to which an investor can be forced to exit its investment against its will. A drag-along right in the voting agreement form covers a 'sale of the company', which is defined as a sale of more than 50 per cent of the voting power of a company or a transaction that would constitute a deemed liquidation event under the company's charter or by-laws. It is important to closely review this cross reference to the company's charter or by-laws to ensure that transactions that should not trigger a drag-along right are not unintentionally included. Whether a drag-along right may be exercised partially may also have an adverse impact on an investor, as it could allow the dragging shareholders to drag a majority of an investor's stake, leaving that investor with an illiquid minority stake below the thresholds that would entitle it to basic rights (such as information rights or pre-emptive rights). As a result, investors will often push for the drag right to be 'all or nothing', meaning that they cannot be dragged unless such transaction would guarantee a full exit for the dragged investor. It is important to consider what block of shareholders can cause a sale of the company to occur, and 'drag' the remaining shareholders against their will. Typically, the affirmative vote of a supermajority of the preferred holders and a majority of the common holders will be required in order to trigger a drag. An investor may seek to protect its investment by negotiating a floor share price beneath which it would not be forced to participate in the transaction. These floors are often tied to a multiple of a financing round's original issue price per share. An investor may also seek the right not to be dragged within some period after the closing of its investment. Finally, an investor will look to require a preferred supermajority vote to trigger the drag so that the investor's interest in the company can exercise the maximum amount of influence, while founders will look to set the drag vote threshold below the point at which any one investor or small group of investors would have the ability to veto a sale of the company.

ROFR and co-sale agreement

The NVCA ROFR and co-sale agreement form establishes:

- a primary right of first refusal granted by the key holders in favour of the company;
- a secondary right of first refusal granted by the key holders in favour of the investors;
- a right of co-sale (tag-along) granted to the investors for any transfer by a key holder for which the company's and the investors' rights of first refusal are not exercised; and
- general transfer restrictions and customary exemptions thereto for permitted transfers.

The secondary right of first refusal for transfers by key holders in the NVCA form contains an 'all or nothing' limitation; namely, if investors agree to purchase fewer shares than all that a key holder proposes to sell to a third party, then the investors are deemed to forfeit their right of first refusal in connection with the transaction. The 'all or nothing' limitation favours key holders, who are more likely to be able to extract the full value of their stakes as a block, as a prospective buyer may attach greater per share value to the acquisition of a larger stake. A sale of shares by key holders of more than 50 per cent of the voting power of a company may constitute a sale of the company under the voting agreement, which, if supported by the requisite shareholders discussed in 'Voting agreement' above, could compel the sale of the shares held by investors to the acquiror. Such a sale would also trigger the requirement in the voting agreement that the sale terms must be open to all holders of preferred stock and the consideration offered must be structured to reflect the liquidation preferences of the classes of preferred shares of the company – thereby preserving investor value.

In some cases, the secondary right of first refusal for transfers by key holders is expanded to also cover transfers by investors. This allows investors to control the composition of the company's shareholders to limit the transfer of shares to, for example, sanctioned persons, affiliates of competitors, or persons with reputational or legal issues. This right, however, this can be a double-edged sword for an investor as it would significantly restrict the liquidity of that investor's stake. The scope of the right of first refusal should be carefully tailored at the term-sheet stage to avoid protracted discussions when drafting definitive documentation. Alternatively, a transfer restriction prohibiting transfers to sanctioned persons and persons with other AML and FCPA related issues can be negotiated and included in the agreements.

As new parties become shareholders in a company, they may be added to the ROFR and co-sale agreement and other NVCA agreements via joinder without the need for a full amended and restated agreement; however, in connection with a new equity raise, the entire agreement would likely be updated for requests specific to the new round's investors.

Charter

The charter (certificate of formation or Incorporation in Delaware; the memorandum and articles in the Cayman Islands; and the by-laws in most civil law Latin American jurisdictions) is one of the most important of the suite of documents to review when considering a venture capital or growth equity investment. The charter or by-laws define the key economic terms of the preferred shares being issued in a particular round of investment, such as the liquidation preference, anti-dilution protection and the events that trigger a forced or automatic conversion of preferred shares to common shares, and establish the mechanics for deemed liquidation events and the conversion of preferred shares to common shares. In addition, the charter or by-laws typically contain shareholder-level veto rights referred to as 'protective provisions' that protect the key terms of a particular series of preferred shares from modification without the relevant investor's consent.

A 'deemed liquidation event' is a defined set of events that, unless waived by a requisite percentage of preferred holders, trigger the distribution of a company's assets to its shareholders, first to satisfy any applicable preferences held by the preferred holders, and thereafter to the shareholders pursuant to the distribution provisions or waterfall of the charter or by-laws. This concept typically includes:

- a sale of all or substantially all of a company's assets or subsidiaries (to the extent that majority of the company's assets are held by its subsidiaries) in a single transaction or a series of related transactions;
- a merger or consolidation where the company's capital stock does not represent a majority of the combined capital stock of the merged company; and
- a sale of a company's intellectual property or key intellectual property, which is particularly relevant for start-ups.

This defined term is of crucial importance not just in the charter or by-laws, but also as a cross referenced term in the other NVCA forms, such as the voting agreement and the ROFR and co-sale agreement, where it can trigger drag-along rights and tag-along rights.

The conversion mechanics in the charter or by-laws allow for optional conversion by an investor of its preferred shares into common shares at any time and provide for the automatic conversion upon the occurrence of a 'qualified public offering'. The definition of qualified public offering is heavily negotiated because it is a public offering that triggers an automatic conversion of all series of preferred shares into common shares without the need for the consent of the preferred shareholders. 'Qualified public offerings' are typically defined as an initial public offering with a price per share offered to the public greater than or equal to a certain threshold, typically some multiple of the last round's price per share, net proceeds to the company in excess of a certain threshold and a listing on a sophisticated market, which can be specified to avoid ambiguity. While initial public offerings have historically been a less likely exit from investment in Latin America as compared to sales to strategic players or secondary funds, as more and more Latin American start-ups consummate successful IPOs abroad the specific components of what constitutes a 'qualified public offering' are becoming more intensely negotiated. The definition of 'qualified public offering' is all the more critical as the NVCA agreements typically terminate upon the occurrence of an initial public offering, meaning that all of the investor's heavily negotiated contractual rights would disappear without the investor's consent.

A debate often occurs over what provisions of the NVCA agreements need to be duplicated conceptually into the charter or by-laws to provide a greater degree of enforceability, particularly against third parties who are then deemed to be on notice as to the existence of such provisions. Board appointment rights, board vetoes, pre-emptive rights and various other provisions contained in the IRA are typically the subject of this discussion. The parties seek to balance the investor's desire for greater enforceability of these rights against the company's desire to limit these key terms into confidential private contracts and not (in some jurisdictions) publicly available documents. Depending on the jurisdiction and the public availability of the charter or by-laws, the parties also seek to limit references to the NVCA agreements in the charter or by-laws as much as possible to avoid them being requested by the relevant government authority and made public (e.g., in England via Companies House).

Other documents and miscellaneous clauses

The share purchase agreement NVCA form (SPA) functions as a typical subscription agreement with some key differences. There is no indemnity for breach of representations and warranties, although there is an ability to recover for a breach of contract. To the extent an indemnity is included (most common for tax and compliance liabilities in Latin American jurisdictions, including Brazil), an investor should carefully negotiate the definition of 'Losses' and ensure that a gross-up provision is included. The indemnity provisions typically apply after closing, when the investor will own a share in the company; therefore, in practice, the investor will be indirectly paying itself a portion of every dollar indemnified by the company. In the absence of indemnity rights against the existing shareholders, the investor should consider the merits of addressing dilution or reduction of future capital contributions as an alternative to cash indemnity payments. Unless there is a cash-out component to the transaction, obtaining indemnity rights against the founders or controlling shareholders is rare in a VC investment. The SPA also does not include any provisions that address risk allocation or operations of the business between signing and closing, which in many Latin American jurisdictions can pose problems as competition and other regulatory approvals can cause long pre-closing periods. Frequently, these shortcomings of the form SPA are addressed separately through side letters.

Side letters may be entered into by an investor and a company to address topics that were not covered in the other NVCA agreements. The NVCA form of management rights letter includes consultation rights, inspections rights, the right to receive minutes and board materials, and it also includes provisions that aim to protect foreign investors from the Committee on Foreign Investment in the United States jurisdiction for investments in companies with operations in the United States. Another provision that is often included in the management rights letter are investor-specific ownership sunset thresholds for the receipt of information rights that are lower than the definition of major investor established in the IRA and applicable to the other shareholders. Remedial covenants for items discovered during due diligence can also be included in the management rights letter (e.g., the execution of intellectual property assignment agreements for key employees and founders that have not yet done so, or the transition from using independent contractors to actual employees fully included in the payroll). Since the form of SPA is tailored to US transactions, country-specific covenants are frequently included in these side letters to avoid negotiating the NVCA form (e.g., covenants to comply with country-specific data protection regulations, to transition from an independent contractor workforce to employees fully included in the payroll, or to take a different approach with respect to the tax characterisation of certain operations on a going forward basis).

As discussed above, most of the NVCA agreements have termination provisions that are triggered by an initial public offering, a sale of the company, or pursuant to the amendment, waiver and consent provisions of each agreement. As with the triggers for a drag-along in the voting agreement, investors should make sure the termination triggers in each agreement are sufficiently narrow and do not include unintended components of a deemed liquidation event to the extent that the defined term in the charter or by-laws is broader than normal. It is important to ensure that the termination and amendment provisions are consistent throughout the VC agreements to avoid ambiguities and potential disputes. Typically, the affirmative vote or consent of key holders holding a certain percentage of a company's common stock and investors holding a certain percentage of a particular series of preferred stock is required for any amendment to the NVCA agreements, but it is not uncommon to see inconsistencies across documents.

Conclusion

Regardless of local preference and the potential benefits of using a familiar shareholders' agreement versus the NVCA agreement forms, if a company intends to continue to raise additional rounds of capital from offshore VC investors, it is likely that at some point the company will be forced to adopt something similar to the NVCA forms. If a company has already adopted this framework in an early round, future investors will most likely not be able to force a change in approach for a later round as the previous investors and the company may not accept the cost and effort required to start from scratch.

Alternatively, founders in countries such as Brazil, that have access to capital from sources within Brazil, often propose a more traditional shareholders agreement and investment or subscription agreement. These founders, particularly those of earlier stage start-ups, may not have the same pressure to change their approach in order to make themselves more attractive to capital abroad as founders of later stage companies or those from countries with fewer ready sources of local capital. As such, the decision to use the NVCA forms (or something similar to them) is unique and the decision to use a particular suite of documents turns on many factors, including the size and sophistication of the investing parties, their experience with international and local investment documentation styles and each party's negotiating leverage.

The intent of the NVCA in creating the NVCA agreements was to streamline terms and documents in the VC sector and reduce costs for both founders and investors who could look to a standard set of documents and facilitate comparisons across deals. However, in practice, various issues arise in the use of the forms without adjustment for Latin American transactions, including:

- The priorities, risk appetite and level of sophistication of each set of founders, in each industry and in each country in the region, varies greatly, so an investor's approach to negotiating and documenting a transaction should also be tailored.
- As the NVCA form agreements address overlapping issues, there is significant potential for inconsistencies when each agreement is adapted to reflect the specific aims of the parties. Similarly, principles of risk allocation and certainty adequately negotiated and documented in one agreement can be confused by the approach to a similar topic in a different agreement, obscuring interpretation issues.
- VC investors can more easily monitor and compare one comprehensive shareholders' agreement for each portfolio company transaction than five or six separate agreements with overlapping topics.
- Many of the NVCA form agreements are crafted with a US legal environment in mind – including, for example, the US Securities and Exchange Commission regulations and

requirements for IPOs, when in fact a vast majority of businessmen operating in Latin America will not provide an exit to the investors through a US IPO.
- Often, topics covered by the NVCA forms will have a customary or even legal treatment under local law of the jurisdiction where a target is incorporated or operates its business, requiring adaptation of the documents that are likely better addressed from precedent shareholders' agreements and by-laws, rather than the forms.

From the perspective of many lawyers active in this market in Latin America, the approach that would most minimise risk to an investor would be to create an initial draft shareholders' agreement that covers all of the topics addressed by the NVCA forms in an all-encompassing agreement. However, owing to the prevalence of these forms in the US market and the fact that US investors in subsequent, larger rounds may refuse to work with a previously executed shareholders' agreement and may request to implement something similar to the NVCA forms as a cost-saving measure and to ensure consistency and ease of comparison across their portfolio companies, the most practical approach for many may be to accept the NVCA forms and to engage sophisticated counsel with experience in both Latin American M&A and VC transactions abroad who can take a critical and focused approach to properly tailor the agreements to the deal in question, specifically considering the cross-border nature of the transaction.

5

Mergers and Acquisitions Involving Family-Owned Targets

Sergio Michelsen, Darío Laguado and Ángela García[1]

Family-owned and controlled companies are the backbone of Latin American economies. More than 85 per cent of the companies in the region are family owned, accounting for 60 per cent of the region's GPD and employing more than 70 per cent of its workforce.[2] In Colombia, for example, as at 2018, 86.5 per cent of operating companies were family owned.[3] These statistics mean that if you work in M&A in Latin America, chances are you will largely be dealing with family-owned targets. Therefore, understanding the particularities of these transactions is key for any practitioner involved in M&A in Latin America.

These deals have many of the same characteristics and challenges of any M&A transaction, with the added complexity associated to the family's strong attachment to the target. Guisser and Gonzalez[4] note that 'insensitivity on the part of buyers and advisers to particular issues that arise in the context of the family-held company has created real problems in many transactions'. These issues can be grouped in three categories: the (understandable) lack of M&A experience of the family facing what is likely a once-in-a-lifetime transaction; the deep economic entanglement between the family and the company; and the strong emotional bond with the business. The combination of these three variables will determine the complexity of the deal and will permeate the deal-making process. If they are not properly managed, the dynamics of the deal may become problematic to the point of affecting, delaying or even frustrating signing or closing. However, if the process is well handled, these challenges will be compensated with factors such as the transfer of knowledge of the

1 Sergio Michelsen and Darío Laguado are partners, and Angela Garcia is a senior associate at Brigard Urrutia.

2 IFC (2018), *IFC Family Business Governance Handbook*, 2018; and EY (2017), 'Family business in Latin America'. http://familybusiness.ey.com/pdfs/page-55-56.pdf .

3 Confecamaras (2018) and *Empresas Familiares en Colombia: un legado que transciende*. PwC (2019) pp. 6.

4 Gisser, M.V. and Gonzalez, E.E. (1993). 'Family businesses: a breed apart in crafting deals'. *Mergers & Acquisitions*. Vol. 27, No. 5, pp. 39-44.

business and its market as well as the relative ease resulting from not having to comply with capital markets regulations applicable to publicly traded companies.[5]

Within this framework, at the intersection of these three variables, this chapter explores the particularities and complexities of M&A transactions involving family-owned companies. The first section describes the deal dynamics and the main challenges in that respect. The second section focuses on substantive points of negotiation that are relevant and perhaps unique to this type of deal. The third section sets forth certain considerations regarding partial sales, particularly shareholders agreements and exit rights. The fourth section concludes.

Deal dynamics: no two families are alike

Data shows that family owned businesses generally do not get involved in acquisitions. The aversion to acquisitions may be explained by the fact that families may not want to risk their financial autonomy or are not willing or do not have the financial means to inject into the business large amounts of capital usually required to complete an acquisition. In contrast, sell-side transactions can 'provide family firms with a successful exit in the case of generational transitions, as well as possibilities for rapid external growth'[6]

Even though no two families (and no two transactions) are alike, the following are certain matters to consider when working with families on either side of the equation.

Is the family ready to sell?

Unlike other institutional shareholders, families think in terms of years, decades or even generations. Therefore, it is not surprising that M&A deals involving families take a long time to build up. Even when a handshake agreement is in place, execution may lag for months or years. In approaching a family, it is extremely convenient to ask if they are truly ready to sell. This can be a function of some of the following variables. First, succession is critical. If the younger generations are not actively involved in the company, this may be a signal that a sale may be in the horizon. Second, families will typically look at long-term market conditions, with a view to strike the best possible price for their lifetime investment. This equation will probably combine the maturity of the business with good market prospects. Third, country risk, especially in Latin America, will play a major role in a family's decision to exit an investment. Fourth, a family will look at its legacy, seeking to assure that the company they consider their life's work will endure through time. Failure to understand if a family is ready to sell or not may be frustrating for buyers, and it is, therefore, advisable to fully assess these and other circumstances before putting the pedal down at full speed.

5 For a review of matters relating to publicly traded targets, see Chapter 7 of this guide, 'Public M&As, Hostile Takeovers and Shareholder Activism'.

6 Worek, Maija (2017). 'Mergers and acquisitions in family businesses: current literature and future insights' *Journal of Family Business Management*. Vol 7. No 2, pp. 177–206.

When should counsel be engaged?

The short answer is the sooner the better. Engaging counsel early in the process can help the family understand and organise the process efficiently from the beginning. It may also assist the family in identifying the issues that will be pivotal in the transaction. Even if counsel is not engaged at the very outset of the process, families should reject the temptation of entering into preliminary agreements (see Chapter 11 of this guide on preliminary agreements) without adequate legal advice. A somewhat common challenge that M&A counsel face when they are hired after the execution of a preliminary agreement is finding that it contains agreements on matters that would otherwise be stock purchase agreement material (typically not precisely in the benefit of the family). These may include procedural terms, such as exclusivity periods, pre-signing covenants, or substantive terms, such as commitments regarding conditions precedent or the indemnity package. In these circumstances, attempts to reestablish the balance at a later point must be carefully proposed because they can affect the trust and credibility of the parties in the process.

Legal advice may also prove useful for the family in the negotiation of mandate agreements with bankers and other advisers.[7]

Identify the decision-makers and potential sources of tension

Whether you are advising the seller or buyer side, you need to understand the dynamics of the family and the decision-making process within it. This knowledge will enable counsel to anticipate possible sources of tension and be prepared to solve them when they arise. Very early in on the process you need to understand who will be leading the negotiation and what is the scope of his or her authority, the clusters of family alliances, the generation to which the respective family members belong, and the majority required to approve corporate actions. For instance, the dynamics of the deal are completely different when you are dealing with parents and their siblings, than when you are dealing with the extended family.

In this context, it is particularly relevant to understand if all the members of the family are aligned in connection with the transaction. If they are not aligned, you must be sure that the family members that are on board with the sale have the majority required to approve it or to transfer control (or the desired stake). Also, although rare, it is crucial to understand if there are rogue family members that may oppose the transaction or may seek to behave opportunistically to extract non-proportional value. In any event, early active discussion with the financial and legal M&A advisers to address any opposition to the transaction is highly recommended. More often than not, opposing family members are better persuaded if they are brought closer to the deal team and actively provided information to build up their trust in the process.

Once the decision-making process has been nailed down, the following tools may be useful to navigate it. When trust among the family members is strong and there is a salient leader, all the family members may grant a proxy to that person and this may be the best way to guarantee deal certainty. Needless to say that the proxy has to be carefully drafted to make

7 See Chapter 6 of this guide, 'The Role of Financial Advisers in Mergers and Acquisitions', which discusses the role of financial advisers in M&A transactions.

sure that it includes all the actions involved in an M&A transaction, such as the transfer of shares, compliance with foreign exchange requirements, execution of the transaction documents, and so on. When a proxy is not in the menu, it may be prudent to design an organised approval process involving committees, defined timelines and other internal agreements to make sure that the process advances swiftly. It is also crucial to make sure that all the family members are comfortable with the fact that the M&A advisers are acting on behalf of the entire family, thereby preventing the proverbial last-minute request of a family member to involve his or her own counsel to review the entire transaction (and even provide mark-ups) a few days before signing. Evidently, establishing trust in the deal advisers becomes even more important when different family clusters are acting independently.

Make sure that the family fully understands the proposed transaction

An M&A transaction is a 'singularity' for a family. Although they are real experts in their business, they are not necessarily (and do not need to be) familiar with the particularities of an M&A process. From the seller's perspective, one of the best uses of M&A counsel's time may be to engage in an M&A 'masterclass' with the members of the family or the target that will participate in the transaction. This provides the opportunity to explain them how the process works, the expectations of the buyer during due diligence, the structuring alternatives, the details and key customary terms of the stock purchase agreement (and in fact what 'SPA' and other common M&A jargon means), the dynamics of the negotiation and the timing of each of these steps.

The sellers will likely be nervous about the process as this is a novel experience for them and the stakes cannot be higher. This exercise will help them understand and be prepared for what is coming, mitigate their fears and build trust in their M&A counsel. Throughout the process, it is convenient to regularly ensure that the family fully understands the terms of the transaction.

Working with trusted advisers

Families regularly rely on their traditional lawyers, who may be generalists and not necessarily M&A specialists. What they lack in experience in this field they compensate with their knowledge of the business and the trust and report they have built with the family over the years. Some act as real 'consigliere', which gives them enormous influence over decision-makers, including as frequent observers in board meetings and crucial company events, and other family celebrations. Therefore, as a matter of loyalty and trust, sellers often hesitate to engage sophisticated M&A lawyers for the transaction. Alternatively and perhaps more frequently, they hire an M&A adviser to team up with their trusted adviser. If you are on the seller's side, this means that you have to educate your client and work in a coordinated manner with your colleague, combining his or her knowledge of the business and the sensibilities of the family with your M&A expertise. This yields strong synergies and deal advantages for the family.

Every once in a while, perhaps increasingly infrequent as M&A markets mature in the region, buyer's counsel has to work in a deal where the selling family has not engaged M&A specialists. At first sight, it could appear that this lack of expertise on the sell side will make the deal a 'piece of cake'. However, reality may often prove to be the opposite. The lack of expertise and the fear of being outperformed or fooled is the perfect cocktail for a nightmare negotiation. A counterparty who does not speak the 'language of M&A' may oppose the most standard provisions simply out of unease or lack of expertise. This is why it is wise for buyers to advise the family to engage M&A specialists. If, despite this, the sellers have not hired M&A advisers, buyer's counsel needs to ensure that the sellers and their advisers properly understand the M&A terms of art and the detailed terms of the transaction documents, so they can trust your expertise and feel comfortable with the reasoning behind your comments and positions with regard to the terms of the transaction.

There are a few good tools to address this issue. A good starting point can be the preliminary agreements,[8] which are shorter but, at the same time, allow the parties to set their expectations in respect of the transaction. From the advisers' standpoint, these initial agreements provide the opportunity to bring the M&A terms of art to the table and explain their relevance in the transaction. Another useful tool to inspire confidence in the counterparty about the M&A terms of art is to use deal point studies, which are studies that survey, record and portray the market standards in the negotiation of certain sensible topics in M&A deals. For example, these studies can be used to illustrate to the parties the market ranges for caps, baskets, *de minimis* provisions, survival periods and the like.

The due diligence process

Due diligence is a very challenging process for a selling family for at least two reasons. First, it carries an important emotional component. A significant hurdle is helping family members understand that disclosure is in fact in their own benefit, since it will enable an adequate risk allocation exercise and will help protect them against a future breach of representations and warranties. Families also need to be advised that it is reasonable and not uncommon that the buyer identifies some contingencies and liabilities. This by itself will not trump a deal; inadequate disclosure may. All of this may sound counterintuitive to some families and may feel like asking proud parents to identify the flaws or weaknesses of their children. Again, the key to managing this emotional hurdle is to educate the family on the importance of due diligence and the benefits of disclosure, while negotiating the best possible deal terms for them.

Second, a due diligence process may be disruptive to day-to-day operations. The process will demand significant resources from the company and will require the involvement of senior management and key employees. M&A counsel should help the family navigate this process. Some key recommendations include tasking investment bankers with the interface with potential buyers,[9] engaging a professional virtual data room provider expert on record keeping tailored to the M&A process and confidentiality and cybersecurity controls (with the exception of very small deals, stay away from Dropbox, Google Drive or other similar cloud-based platforms that do not provide those functionalities), ensuring that the family appoints one key person in the company who will be coordinating all the diligence efforts;

8 See Chapter 11 of this guide, 'Preliminary Legal Documents in M&A Transactions'.

9 See Chapter 6 of this guide, 'The Role of Financial Advisers in Mergers and Acquisitions'.

designing with management the architecture of the data room (from the overall folder structure to details such as naming the files according to their content); providing advice as to what information is relevant and what information is not (for example, by defining materiality thresholds), etc.

A well-conceived and organised data room will save tons of work and time, send a powerful signal of good management to the buyer and help strengthen trust during the process.

From the buyers' perspective, the main challenge arises when the sellers do not hire investment bankers or M&A counsel for the process, and they prefer to use their internal resources for the due diligence process. Working on the due diligence directly with the employees of the target is not per se a bad idea; it has its pros and cons. On the one hand, it is very useful for the buyer to have a direct relationship with the individuals that have handled the issues in the target and that really know the particularities of the business. On the other hand, sometimes managers and employees feel a need to minimise existing issues rather than address them objectively, mainly because they are worried the issues may reflect poorly on them personally, and thus may feel challenged and audited by their counterparty (sometimes resulting in fear of losing their jobs as a result of the deal). To benefit from a direct relationship with the target while ensuring an effective diligence process, buyer's counsel needs to approach the employees respectfully, making them feel comfortable sharing the information and their opinions about the issues under discussion, while explaining the need to be open and candid about the facts of the business. As with everything in life, being respectful is key to success.

Confidentiality

In the age of information, protecting the trade secrets and the confidential information of the family business is a crucial aspect of an M&A deal. We suggest considering at least the following aspects. First, if the buyer is a competitor (which is quite usual), the family should be advised that the execution of a standard confidentiality agreement may not be enough, mainly due to hardship proving breach, damages and causality. It is, therefore, prudent to complement it with other practical measures to protect the most sensitive information of the company. For example, the disclosure of price lists, clients, suppliers and other strategic matters may be delayed until an advanced phase of the process, when approaching deal certainty. In addition, logistical protections can be put in place, such as limiting the ability to print or download the information from the virtual data room and password protect certain key documents. Further, when there are antitrust concerns, the buyer may be required to set up a 'clean team' to make sure that material non-public information is only accessed by persons that are not engaged in the day-to-day business of the acquiring company.

The second aspect is to consider if the family members need or prefer to keep the deal confidential. In addition to commercial, financial and strategic reasons, anonymity is typically important in our region due to security and privacy concerns. To address this, the transaction documents must include robust confidentiality provisions restricting public disclosure. Of course, buyers may oppose this since they may be interested in announcing the deal for commercial reasons or may be required to do so for legal reasons (for example, securities regulations). When this is the case, the parties may agree on what information may or not be disclosed freely. For example, the family may accept that the transaction be disclosed but may request the buyer to keep the price and the identity of the family members confidential to the maximum extent permitted by law. In these instances, it is also prudent to make sure that the confidentiality agreements with the advisers include express provisions to avoid any undesired disclosure of the transaction.

Finally, the sellers need to determine how to maintain the confidentiality of the transaction during the negotiation process to avoid speculation and anxiety among the company's main stakeholders. For this purpose, it is advisable to engage a limited number of employees in the process and ask them to sign confidentiality agreements in a personal capacity. Key employees may be offered a success or retention bonus if the transaction is consummated to align interests. They should also be made aware of the adverse effects that any leakage may cause to the process.

Negotiation of the transaction documents: do not underestimate the seller's attachment to its ways

When sellers are not used to participating in M&A transactions, there is a natural tension between their pragmatic approach and the standards set by sophisticated investors. Family businesses are usually entirely built by their owners: very successful entrepreneurs that can recall how they started their business from scratch with just a briefcase, a phone and a lot of hard work. Many sellers also believe that they have built their business based on the effectiveness of a reliable handshake and are confident about their approach and instinct for business.

However, M&A practice and standards are clearly not as simple as a handshake. This creates a natural tension between sellers and buyers, especially with institutional buyers who need to meet certain standards for obtaining the approvals of their investment committees. While one side of the table aims for a short agreement, evidence of the wire transfer and a well-earned vacation, the other party needs a comprehensive agreement with robust risk allocation clauses and a detailed disclosure under recognised international standards and best practices.

In this scenario, it is advisable that the M&A specialist take control of the documents and be as efficient as possible. It is not an easy task, but it is necessary to meet the client's needs and facilitate the decision-making process. Naturally, in that case, counsel should produce balanced documents and avoid departing from customary terms. All the time saved on the drafting of the agreements may be wasted if the counterparties lose trust in the M&A specialist. Finally, provide the counterparty a reasonable time frame to read and understand the agreements, and include contractual provisions that protect the integrity of the agreement by having all parties acknowledge they had the opportunity to hire counsel and receive advice, and no negative inference should be used against the drafting party.

Wealth management

Upon closing the transaction, the family will likely experience a major liquidity event. Counsel can help the family prepare for this by making adequate tax planning and wealth management. The financial advisers of the family may also play a key role in this respect, helping them diversify their investments and setting up the required infrastructure to manage the resulting liquidity.

Substantive points of negotiation

Once we have tackled the deal dynamics, it is time to address the major substantive points that are relevant when the target is a family-owned company. In addition to the standard provisions and the usual hurdles of an asset or share purchase agreement (such as the price adjustment mechanism, the conditions to closing and the indemnity package), the following matters require special attention.

Untangling the family from the business: related party transactions, commingled assets and guarantees.

Regardless of your side on the table, special attention needs to be paid to the entanglement between the affairs of the family members and the affairs of the target.

First, related-party transactions need to be assessed to determine which of them should continue after closing. If members of the family will continue providing services to the acquired target, ensure that such agreements are duly reviewed and, if required, amended and restated to include arm's-length provisions.

Further, the company may own assets that are unrelated to its core activities and are in fact devoted to the family. This may be the case with respect to real estate, vehicles, etc. The opposite may also be true; certain core assets of the business may be registered under the names of family members. For example, a relevant brand or software, real estate or other asset. Both buyer and seller must be fully aware of this situation to set forth the appropriate contractual provisions to transfer these assets to their rightful owner taking into account the perimeter of the transaction. Counsel should anticipate and to the extent possible minimise or avert delays and adverse tax consequences in connection with the transfer of these assets.

Finally, it is also common that the family members have provided personal guarantees in connection with the business of the company, or vice-versa. For example, it is common practice in Latin America that banks require the shareholders to issue personal guarantees to secure the loans to the company. These guarantees need to be replaced on closing or shortly thereafter, and the transaction documents must set clear deadlines and procedures to do so.

From owner to employee

Regardless of whether the transaction is structured as a full or a partial sale, family members may continue to be employed by the company after closing. This may be beneficial for both parties. Sellers may benefit personally, by making sure that they retain a source of income and professional engagement. This may also have important emotional effects on certain family members, making it easier to close a deal and secure a swift transition. Buyers may also benefit greatly from this. The expertise of the family members in the management and the business of the company can be crucial to boost its performance. When this happens, the golden rule is to make sure that the terms of engagement are clear both in paper and in the minds of the persons involved.[10]

Buyer's counsel should identify the type of engagement that the family members had with the company prior to the transaction. It is not unusual to find that no written agreement exists and, when it does, that its terms are different from those that apply in reality (particularly regarding salary and other benefits). To avoid future liabilities in this regard, it is advisable to consider whether it is necessary to terminate and settle the prior arrangements between the family members and the company and enter into new agreements upon closing. Going forward, the parties must clearly set forth the new rules of engagement, which, in addition to economic benefits, can address issues such as the policy for business travels, the number of hours per week that the family member needs to commit to the business and non-compete matters.

Counsel for the sellers should make sure that the expectations of the family members are properly addressed. Perhaps the most outstanding item in this respect is stability. When the family member intends to retain its position after closing (an item that may be part of the economic rationale of the deal), including in the case of an early exit of the investor or the arrival of new investors, it may be advisable to negotiate a golden parachute (a provision to guarantee a financial compensation to the executives of the target if they are dismissed within a certain period after a merger or a change of control of the target). Also, counsel should guide its client in making sure that other matters are clearly agreed upon, such as extended vacations, performance bonuses, dedication and the possibility to engage in other businesses.

Finally, it is worth making sure that all family members that continue to be engaged by the company fully digest that their role will change dramatically, from that of owner to that of employee.

Non-compete provisions

Non-compete provisions are especially important and challenging in connection with family-owned companies. Buyers usually look forward for broad non-compete provisions as part of the bargained-for benefit flowing from the acquisition. A former owner engaging in a competing business shortly after the transaction has the potential to significantly detract from the value of the business and its projections as factored in by buyers in their financial models. This is a real concern in this setting since family members possess deep knowledge of the market and a strong network. On the other hand, families may be particularly sensitive to non-compete restrictions, since they have spent all their life in a particular business, and they do not want to completely give up opportunities that may arise in their area of expertise. Also, the discussion of non-compete provisions and adequate compensation thereof may be a source of tension among family members because the family members that actually work in the relevant business will be disproportionately impacted by the

10 Counsel should be mindful of potential conflicts of interest depending on the party that contractually retained them. Counsel may be hired by the target itself, by one seller or by all the sellers. Counsel's duties are owed to the specific retaining parties.

non-compete. The counsel's job here is to strike the right balance, making sure that the buyer can take the benefit of an interference-free business for a reasonable period, while the family can continue to engage in certain permitted activities.

The drafting of a non-compete provision is a subtle art, but broadly speaking, it gravitates around the following questions:

- Who will be bound by the non-compete? Yes, the family members. But all of them? What about spouses? What about family members who sell a small stake (e.g., 5 per cent)?
- What is the scope of the restriction? In this respect, in addition to defining the restricted activities, it is possible (and quite common) to define specific exclusions or exceptions to make sure that the family can continue developing existing non-core businesses or lines of business in the pipeline that may fall in a grey area.
- What is the duration? Three years appears to be on the safe side and five years seems to be approaching the outer limit of enforceability in most jurisdictions.
- What is the territory within which the sellers cannot compete? Typically, this should match the current geographical scope of the business. As portrayed, there are rules of thumb for each of these questions, but in the end it will be the counsel's specific task to adjust these variables to come up with a construct that is agreeable to both parties and tailored to the particular circumstances.

From a more technical perspective, the buyer's counsel should make sure that the agreement is enforceable in the respective jurisdictions, particularly in light of antitrust rules. Matters seem to be converging in the region in this respect, with the authorities enforcing reasonable non-compete provisions in the context of M&A transactions. In Colombia, for example, non-compete provisions were considered per se anticompetitive until 2010. However, this changed with the increase of M&A activity. That year, the Colombian competition authority[11] indicated that non-compete provisions are enforceable if they (1) do not constitute the main purpose of the contract, but rather a secondary obligation of a broader deal (such as an M&A deal); (2) are reasonable in both geographic scope and term; and (3) are necessary to maintain the value of the broader deal.

Another issue to consider is whether a non-compete is enforceable *vis-à-vis* an individual (as opposed to a company). In certain jurisdictions, an individual may successfully challenge a non-compete provision based on constitutional grounds (e.g., the individual's constitutional rights to freely choose its occupation or the right to employment). In these cases, the purpose of the non-compete could be satisfied by means of other commercial agreements in aid of the non-compete clause, such as provisions seeking to limit the possibility to use the know-how of the target (e.g., with strict confidentiality agreements) or requiring the individual to invite the buyer to participate in new competing businesses.

Negotiating the security package to protect the family's patrimony

Many M&A practitioners will agree that the indemnity package tends to be the one of the elements of the purchase agreement on which the parties focus much of their attention.

11 Supeintendencia de Industria y Comercio. Resolution 46325 of 2010.

This may be even more relevant when families are involved because post-closing indemnification payments directly affect their personal wealth (unlike large publicly traded corporations or investment funds).

A poorly balanced indemnity package may expose the family's patrimony and lifetime's work, eroding the benefits of the transaction as well as imposing long-term organisational, administrative, accounting and liquidity requirements. The following are some of the salient challenges in this respect when dealing with a family-owned company.

No recourse or an 'as is where is' standard is not common in private M&A transactions.[12] A good indicator of this is the fact that deal points studies generally do not address the percentage of deals without indemnification provisions.[13] However, selling families sometimes express that they do not want to be held liable for any loss after the closing of the transaction and they often don't appreciate the fact that such expectation, if it can be met at all, would likely come with a significant discount on the price tag or a reduction in the number of parties interested in acquiring the business. M&A practitioners need to be prepared for this discussion to show the family the pros and cons of agreeing to certain indemnification obligations.

From the seller's side, counsel must pay extra attention to the elements of the indemnity package and discuss thoroughly with the family the terms thereof. The overall exposure will mainly be a variable of the amounts assigned to the cap, the survival period, the basket, and the *de minimis* provision. Different sellers may have different preferences and company dynamics may warrant different treatment from deal to deal. Some may prefer to have a higher cap but a shorter survival period, while others may prefer the opposite. Some may prefer a high tipping basket, others may prefer a lower deductible basket. These examples are an oversimplification, since the above-mentioned elements may be combined through multiple permutations, but they show the importance of working closely with the family to explore what works best for them.

From the buyer's perspective, the indemnification obligations may only be as good as the collateral backing them. For good reasons, creditworthiness going forward is a significant concern of buyers when sellers are individuals instead of operating companies. The most typical mechanism to secure indemnity payments is to deposit in escrow a percentage of the purchase price or to hold back such amount for an agreed period (see Chapter 14 of this guide). Escrow or holdback provisions may also benefit the family when several of its members are acting as sellers. Indeed, it may alleviate the debate between joint and several liability, it may act as a reserve for the family to attend for future liabilities and it may reduce coordination costs in case of litigation.

Representation and warranty insurance is slowly becoming another option to address these problems. Although it is common practice in the United States, this type of insurance is just taking off in Latin America and currently it is costly and not always easy to obtain,

12 A new approach to no-recourse deals has been evolving in the region, especially in cases where there are many sellers or the asset is distressed.

13 Deal points addresses very comprehensive matters related to indemnity provisions, such as: types of indemnities, pro and anti-sandbagging provisions, survival periods and exclusions. But usually no reference is made to 'as is where is' transactions. (SRS Acquiom, Inc. 2020 M&A Deal Terms Study.)

especially for medium- and small-sized transactions. However, we expect that these products will gain more traction in the market considering their effectiveness in protecting the interests of the buyer and releasing the seller from post-closing indemnification obligations.

Special considerations regarding partial sales

One of the most relevant questions when a family is considering a sale is whether to sell less than 100 per cent of the target. This decision will determine the structure of the transaction, the terms of the transaction documents, the type of relationship with the prospective buyer, the future relationship with the company, etc. The following are some relevant issues to consider in this respect.

The rationale for a partial sale

Family-owned businesses are attractive for strategic or private equity investors because, in addition to their profitability and position in their markets, they are diamonds in the rough with much room for improvement. It is not unusual that buyers (especially private equity funds) prefer partial acquisitions as they look to create synergies with the deep market knowledge and robust network of the family.

From the seller's perspective, it is not uncommon either for the family to opt for a partial divestment. If it wants to retain control, institutional investors may bring fresh funds to boost the performance of the company or to develop the projects that the current shareholders have not been able to fund. On the other hand, if the family prefers to keep a minority stake, they can profit from the results of the new management of the company without having to put all their wealth at risk.

Both sellers and buyers may also seek for two-step acquisition structures in which either party has the right to buy or sell, as the case may be, the stake retained by the family at a future time (for example, three or five years later). A buyer may be attracted by this structure since it permits the buyer to implement an organised, phased-in takeover of the operations and to fully capture the know-how of the family. This structure may also allow the family to benefit from the upside resulting from the buyer's injection of capital or managerial assets into the company by selling the retained stake at a better price in the future.

The starring role of the shareholders' agreement

In any situation in which the family is retaining an interest in the company, a shareholders' agreement becomes a critical tool of the new alliance. If the family is selling control, there is even more pressure to enter into a shareholders' agreement that adequately protects its interests after losing the ability to guide the business and take corporate decisions. Shareholders agreements go beyond organisational matters; they become long-term operational rules. They help facilitate the adjustment process that family members must undergo after closing a partial sale, including adjustments related to (1) the loss of some or all of the power to take the decisions of the target at their own discretion, (2) the loss of social clout associated with the business and (3) the loss of control over the finances of the target and the need to separate them from their own finances.

It is difficult for family members having to report and be accountable to third parties, to be forced into imposed schedules and be required to discuss and reach agreements with buyer-appointed individuals with whom they have not yet built relationships and who have different approaches to the business. It is particularly challenging to realise that they cannot spend or invest the money of the target at their own discretion. There is no pre-established formula to facilitate the process of detachment that the family members must go through, but a strong and robust shareholders agreement and clarity during negotiations help avoid unnecessary conflicts. Among others, the shareholders' agreement must help resolve the following questions:

- How are relevant decisions taken and what will be the role of the family in this respect?
- How will the board be appointed and how many members will the family nominate?
- Who will be manage the company on a day-to-day basis?
- What happens if the family and the investor have a major disagreement regarding the future of the company?
- When and under what conditions will the family have a right to sell its remaining interest?

The shareholders agreement is a highly fact-sensitive document, which needs to be tailored to the specific circumstances at hand, including in connection with the ownership structure of the company and shareholder groups thereunder, the type of business and the industry and jurisdictions in which it operates, among others. Latin American M&A practice has largely drawn from US practice (mostly New York and Delaware) with respect to the structure, drafting approach and subject matters covered in a typical shareholders agreement. However, M&A practitioners have tailored these instruments to make them compliant with local law and with local business culture. In this context, regardless of the applicable law of the transaction documents, M&A practitioners need to be wary of unchecked use of forms that have been designed with a US or other foreign perspective in mind to enure that they are suitable for the local context.

Veto rights

Veto rights are extremely important for the minority shareholder (quite often the family). In the absence of contractual veto rights, it is possible that corporate law affords little to no power to the minority shareholder to object major (or any) decisions at the shareholder level. That is certainly the case in Colombia. Therefore, if the family has transferred control, it should seek to retain a reasonable set of veto rights. The extent and strength of these rights will depend on the size of the stake retained and the bargaining power of the parties. There is no clear objective threshold, but the list of veto rights will undoubtedly look different if the family holds, for instance, 20 per cent instead of 49 per cent. In the first case, a minority shareholder will typically only retain protective rights, which are aimed at protecting the economic investment of the shareholder. Some customary vetoes in this respect include anti-dilution rights, vetoes with respect to related-party transactions, vetoes with respect to major changes in the capital structure (reacquisition of shares, stock splits, etc.) and vetoes regarding major decisions, such as mergers, reorganisations, the disposition of all or substantially all of the assets, liquidation, etc. In the second case, a minority shareholder will likely be able to ask, in addition, for participation rights, which will allow that shareholder to actively participate in the business. These will include veto rights regarding the business plan, the annual budget, the appointment or removal of certain officers, the execution of certain agreements, etc. 'Sunset' provisions, pursuant to which a party may lose all or part of its veto rights if its participation dilutes below a specific threshold, are common in this type of agreements.

Exit rights and transfer restrictions

Exit rights constitute another crucial component of shareholders' agreements. Exit rights are particularly relevant for professional investors, such as private equity funds, who need to liquidate their positions within a defined investment period.[14] Families also typically look forward to securing exit rights as part of their longer-term strategy and as a safe harbor if things do not work out as expected. This is particularly important in two-step acquisitions as described above.

The parties usually agree to detailed private market alternatives on exit provisions such as drag along and tag along rights, or put options, especially since the general rule in the region, with certain notable exceptions in Brazil and perhaps Mexico, is that IPOs are rare as an exit option. Some such alternatives provide a certain exit, such as put options, other mechanisms simply increase liquidity, such as drag-along rights, and others are mainly designed to protect minority shareholders from changes in ownership and to allow them to share in control premiums, such as such as tag-along rights. In any event, the main challenge in this respect is to make sure that these provisions are bullet-proof and that, when the time comes, they will be self-enforceable even against the will of one of the parties. This explains why these provisions are so detailed and may dwell on every aspect of a future transaction and everything that may potentially go wrong. How is the purchase price determined? Should there be a minimum price? Is notice required and, if so, what information must be included? Is non-cash consideration permissible? These are just a few examples of questions that will come up with respect to any exit mechanism.

Provisions involving dealings with a third party, such as drag along or tag along rights, pose additional challenges. Is the exit triggered on an 'all or nothing' or on a proportional basis? Does the dragged or tagging party have to give representations and warranties and grant indemnity? Does it have to become a party to the escrow agreement if there is one? Does it have the right to comment the purchase agreement? What type of ancillary or related dealings should be deemed consideration for purposes of determining equal price, terms and conditions? Can the dragged or tagging party audit the transaction and consideration received therefor? What happens if the proposed consideration is not cash, or a mix of cash and other type of consideration?

Of course, the ideal scenario (and indeed a quite common one) is that both parties work jointly towards a joint sale; however well negotiated and drafted, exit rights serve as an incentive to promote this type of cooperation, and every once in a while, they may see their day in court.

14 See Chapters 3 and 4 of this guide.

While exit mechanisms provide liquidity, transfer restrictions such as rights of first offer, rights of first refusal and lock-ups, are designed to provide the shareholders some control over the ownership composition of the company, the terms in which the shares are sold in the market and the type of investors allowed into the company, among others. In recent times in which the region has been shaken by corruption scandals and increased anti-corruption and anti-money laundering regulations, it is more common to see transfer restrictions prohibiting sales to investors that do not fit a certain profile or standards, such as investors that have been convicted or are under investigation for corruption, money laundering and other criminal offences. For similar reasons, the parties may agree to put options or other exit mechanisms that will be triggered if the other party becomes subject to any of these measures to quickly unwind the partnership and avoid or mitigate a contamination risk.

Finally, it is important to assess to what extent these exit mechanisms and transfer restrictions are enforceable in the respective jurisdiction and, most relevantly, to understand what remedies are available in the case of breach. In Colombia, for example, this will vary depending on the type of company and the observance of specific requirements. At the risk of overgeneralisation, in a stock corporation (*sociedad anónima*) and under certain circumstances, a party may only be able to claim damages if a party breaches one of these agreements, while he or she may be able to obtain specific performance in a simplified stock corporation (*sociedad por acciones simplificada*).

Takeaways and conclusions

Family-owned businesses are crucial participants in the Latin American market and therefore predominant targets of M&A activity in the region. When working in M&A deals with families (on either side of the equation), it is worth keeping in mind that the family may be unfamiliar with M&A practice, may be deeply entangled with the company from an economic perspective and may have a strong emotional bond with it. These factors will affect the deal dynamics in a way that is not necessarily present in other deals, making it important to understand and respect the internal decision-making process, ensure the family is fully advised regarding the terms of the transaction and their implications and work closely with trusted advisers. These factors will also impact the substantive terms of the negotiation, which need to be tailored to meet the family's expectations and circumstances, including disentangling the family affairs from the company affairs, protecting the expectation of family members to continue working with the company, striking well-balanced non-compete provisions to preserve the value of the sold business while not unduly limiting the family members' actions and negotiating reasonable indemnity packages. Finally, it is important to keep in mind that many families prefer to opt for a partial sale, which leads to joint ownership creating a whole set of additional concerns. Both buyer' and seller's counsel would do well understanding these dynamics and tensions in order to provide more value-added advice and help the parties close a successful deal with full understanding of their commitments and risks.

6

The Role of Financial Advisers in Merger and Acquisitions

Nicolas Camacho and Vanessa Dager[1]

As further explained in the introduction of this Guide, M&A transactions can take many forms or structures. Among others, companies may seek to merge operating businesses, acquire companies or assets, engage in an auction process to find a suitable buyer, enter into bilateral negotiations for the purchase and sale of the business, or seek joint ventures to combine forces while preserving their corporate structures. The role of financial advisers in each type of M&A transaction may vary but there are some common topics that characterise the adviser's role. This article will focus on a sale process of a private company through a competitive auction, in which the financial adviser is representing the sellers. We selected this example as it is typically where the role of the financial adviser is predominant, which helps illustrate critical points applicable to all processes.

When it comes to buying or selling valuable assets – be it real estate, a piece of art or a vintage car – many owners and investors rely on experts. Generally, from a seller's perspective, these experts mainly focus on maximising the specific asset's value, usually by designing a sale process that seeks competition from a wide array of potential buyers all competing simultaneously, as, for example, in the case of the sale of a painting via a reputable auction house or a bidding war created by a realtor over an apartment.[2] The main difference, however, between auctions designed to sell valuable assets and the process of selling a company through an M&A process is that determining the appropriate valuation is a more complex process that requires spending time and money to understand the details of such business. Among other things, a business is a going concern that evolves with the passage of time and accumulates assets, liabilities, opportunities and risks that impact

1 Nicolas Camacho and Vanessa Dager are managing directors in the M&A team at Credit Suisse.

2 While not addressed in detail in this article, financial advisers representing buyers in such type of process will be focused on negotiating appropriate valuation from their clients' perspective and guiding them through the process in a manner that maximises the opportunity to win the asset within the price range and risk appetite of their client.

its valuation. Considering this, the fundamental role of a financial adviser in the sale of a company is to design and run a sale process that maximises value for the company's shareholders and minimises the burden imposed on management by multiple buyers trying to understand the ins and outs of the business.

Running a simple auction for a private company the way it is done with a Picasso painting would be inefficient as buyers that do not have enough time to understand the details of a business will never be willing to pay top dollar, as they will inevitably price in the uncertainty of any unknown issues that could materially reduce the value of the asset. For a buyer to adequately price a business it must understand its capacity to create value (either through its cash flow-generating capabilities, by identifying synergies with another existing business or by creating business opportunities not otherwise available, like entering into a growth market). It must also grasp and measure the business liabilities and risks to be considered and subtracted from the purchase price to make sure the value-generating capabilities are effectively offset by the value-hindering liabilities. It is the seller's financial adviser's responsibility to make sure that all the value-generating capabilities are uncovered, highlighted and marketed to buyers, as well as to provide information on the value-hindering obligations so buyers have all the information they need to appropriately evaluate the opportunity. An experienced M&A financial adviser on the sell-side should be able to design and run a process that gives just the right amount of time to the most likely potential buyers to analyse and understand a business, while at the same time sustaining the momentum and pressure created by an auction in seeking the highest possible price from buyers.

The cornerstone of a well-designed sale process and a substantial portion of the value a financial adviser brings to the table takes place in the preparation phase, long before any potential buyers are contacted. During this phase, the adviser gets to know the business in detail, identifies and addresses potential transaction issues, clearly defines the set of buyers to be contacted and the approach tactics to be used, prepares the marketing materials and designs a sale process with specific timing milestones.

The first step in the preparation phase is for the financial adviser to get to know and understand the business in detail and proactively identify key issues and risks and their respective mitigants. A good financial adviser should spend the necessary time before launching a sale process analysing and scrutinising the business to be sold. Only through this dedicated time and effort will the financial adviser be able to identify, promote and emphasise the investment highlights of the company that will ultimately attract the interest of buyers, and support the expected valuation. Additionally, this preliminary due diligence will also enable the adviser to be prepared to answer accurately the many questions and inquiries buyers will have throughout the process, thereby minimising the burden on management and adding certainty to the process.

While performing this business due diligence, the financial adviser should also take the time to engage with management and shareholders and anticipate answers to some predictable but critical questions around the strategic rationale of the transaction that will surely arise from some buyers: 'If the company is performing so well, why are you selling now?'; 'Will you be willing to stay on as a minority partner for some more years?'; 'Will you be willing to continue working for the company after you've sold it?', as well as questions around the company's historic performance and legal standing that will arise during diligence. In addition to having the right answers to business and strategic questions – which will only enhance the value of the business – a financial adviser should also anticipate potential legal, regulatory and contractual matters and risks that could impact the sale, its timing and the price buyers are willing to pay. These are typically identified and assessed in close collaboration with legal counsel. The most typical issues in this area include antitrust approvals (depending on the identity and business of the buyer), labour, environmental and other regulatory concerns or specific industry approvals that may be required. If a financial adviser does not anticipate these types of hurdles before launching a process and more importantly, does not implement mitigating potential solutions, that adviser would be forced to improvise by tackling these impediments in real time. Improvisation is one of the worst enemies of getting a deal done – so it should be the adviser's role to foresee and address the potential obstructions before they appear, so all the parties involved are prepared and have a plan to confront the particular challenges.

All the knowledge obtained during the financial adviser's due diligence will be the foundation for the preparation of the marketing materials required for the sale process. The fundamental objective of these materials is to generate interest from potential buyers by highlighting the attractiveness and uniqueness of the investment opportunity, but it is also important that the materials be sufficiently comprehensive for a purchaser to estimate the price it is willing to pay for the company. These materials usually consist of a very brief teaser used to gauge preliminary interest from buyers and then, after confidentiality agreements[3] are signed with those who want to further analyse the opportunity, an information memorandum including a detailed description of the business, usually centred on the operational and financial aspects of the business that is made available. These marketing materials usually include detailed financial projections used by buyers to understand the business's cash flow generation capabilities, which in turn will serve as the base for the valuation analysis that will determine the price they are ultimately willing to pay to purchase the company. The financial advisers will work with counsel to ensure that the marketing materials do not give rise to obligations of the sellers, unless and until binding negotiated agreements have been signed.

In parallel, the adviser also prepares, usually in coordination with management and the shareholders, a list of potential buyers to be contacted during the process. To select the right list of buyers it is important to consider the size of the transaction, the structure of the deal (e.g., minority versus sale of control, which may impact the preference for a strategic buyer versus a private equity or similar investor), the industry dynamics and a buyer's ability to pay. Just as important as identifying potential interested parties is coming up with a strategy to approach each buyer, including how to position the story and who is the right person inside an organisation to be contacted. On this particular topic, the experience and track record of the financial adviser is key, as many processes fail to engage some potential buyers because the wrong person was contacted or because the adviser did not have the ability to

3 See Chapter 11, 'Preliminary Legal Documents in M&A Transactions'.

reach the right executive or decision-maker. An adviser's experience in the industry and region where it operates will assure that the opportunity reaches the right individuals – those who will make sure it is thoroughly analysed and pushed within the potential buyer's organisation and hierarchy. The advisers' track record will also ensure such individuals give full credibility to the process and the opportunity.

The final step of the preparation phase, before officially contacting buyers, is to design the sale process per se. Processes can range from having only one or a few selected parties contacted, to a broad auction process where multiple buyers are approached. Selecting the right type of process will depend on the objectives of the selling shareholders, the views on how broad the buyer universe is, as well as current market and industry dynamics. The decision between a targeted versus a broad auction process involves a trade-off between confidentiality, duration and competitiveness. Usually, when it comes to maximising value, competition (or the appearance of it) is absolutely necessary. Every company has a theoretical value that can be estimated using relatively standard valuation techniques (a discounted cash flow being the most common).[4] Regardless of the value, a sale process reveals what the market is willing to pay for a particular asset or company – its price. A well-designed sale process should seek to obtain the price the market is willing to pay and, in certain occasions, to surpass the theoretical valuation of the company. It is usually through competitive tension that this result is obtained.

Once the preparation stage is over, the sale process begins with the initial approach to buyers. At this point, a typical auction usually involves two phases. During the first phase, once potential buyers express interest in learning about the opportunity, detailed information (including the marketing materials and business plan) is shared with those buyers willing to execute confidentiality agreements. Buyers are then usually given a certain amount of time to analyse the materials and, if interested, to send a non-binding offer indicating the purchase price they would be prepared to offer for the company. These preliminary or non-binding offers give the target's shareholders an indication of the price range buyers are willing to transact and enables shareholders to narrow down the number of prospective buyers to invite to the second phase. During the second phase, buyers still participating in the process are provided access to information, usually through a virtual data room, required to complete due diligence as well as access to management and site visits.

The advantage of structuring the sale process in two phases is that it enables sellers to evaluate preliminary offers and narrow the list of buyers based on the initial indications of interest without a significant level of interaction and having shared a limited amount of information. Once a selected group of buyers gets invited to participate in the second phase (also known as the due diligence phase), buyers will have the chance to interact with management and sometimes shareholders. Sellers then have more confidence that they are sharing detailed information and interacting and spending valuable time with potential buyers that have expressed interest, therefore concentrating their efforts only on buyers who have expressed a credible willingness (subject to due diligence, of course) to purchase

4 Other valuation techniques commonly used when valuing companies include relative valuation based on comparable public companies trading multiples and comparable precedent transactions multiples.

the company at an attractive price and are interested enough to invest some time and money further pursuing the opportunity.

This second phase of the process, involving these pre-selected buyers, centres on facilitating due diligence. Here, the financial adviser plays a key role as he or she designs, organises and oversees three aspects of a typical due diligence process. First, buyers have the opportunity to meet and interact with management. This is usually set up as a formal presentation with each potential buyer where key members of the management team get to present the company. This meeting evolves into a Q&A session with each buyer that is seeking to understand details of the business that may impact valuation or other terms. All the materials used in this presentation as well as all the logistics involved in organising numerous meetings with each potential buyer are led by the financial adviser, including thoroughly preparing management for the process. Second, buyers are usually invited to visit the seller's key facilities. The logistics as well as the design of the visit protocols and rules is led and steered by the financial adviser. Third and finally, the due diligence process gives access to all the relevant seller documentation a buyer needs to review and analyse through a virtual data room. For a data room to be useful and fulfil its purpose, it has to be comprehensive and include any relevant and material documents that would enable a buyer to understand, analyse and verify that all the information communicated throughout the marketing materials was accurate. During the process, the financial advisers also closely cooperate with counsel, including to ensure the protection of commercially sensitive information from competitors that may be involved in the process, avoiding breaching regulatory restrictions on information sharing among competitors, and to identify third parties that may have consent rights on the transaction or on the sharing of information.

Approaching the end of the due diligence process, the financial adviser will ask potential buyers still participating in the process to present final offers. As opposed to the preliminary non-binding offers, in this case offers are expected to include buyer's comments to a draft purchase agreement (PA), and if applicable, a shareholders agreement (SHA), in each case, prepared by the seller's legal advisers, which will detail all terms and conditions (in addition to price) for the proposed transaction. If the process has been successful in its objectives and the asset has attracted enough buyers, the financial adviser should be able to create competitive tension among potential buyers with a clear and defined timing throughout the process to ensure buyers are able to submit a definitive offer at the same time and by providing the same level of due diligence information and access to management to ensure the offers submitted are comparable.

In a situation where this is achieved, the seller will be faced with the decision of whom to sell the company to. Although on some occasions this is a very straightforward decision (value differentiation is usually the predominant driver in selecting the winning offer), in most cases this decision requires further considerations. One of the key roles of an M&A financial adviser is to help sellers evaluate all the components of the different proposals from potential buyers, beyond just the purchase price. Things to consider besides value include, among others, the ability of a buyer to pay (including ability to secure financing), key terms suggested in the PA (and SHA, if applicable), any antitrust considerations or other regulatory or third-party approvals required, future plans for the company and for the employees, and in cases where there is stock consideration in the purchase price, valuation thereof as well as the future growth potential and performance of the combined entity.[5]

This is not always a straightforward process as various questions usually arise when considering these factors and the way they could impact a potential transaction: How do you qualify and quantify them? Which could have the most material impact? How do you compare them among bidders? Responding these questions is where both legal and financial M&A advisers' previous experience and knowledge are most relevant for sellers, as at this point M&A becomes more of an art than a science. Also relevant at this point is the interaction the financial adviser has had with potential buyers during the process. As described earlier, sale processes are usually designed in a way that provides multiple points of interaction between potential buyers, M&A advisers and sellers. These interactions allow advisers to gather information and assess the level of interest of a particular buyer, the amount of work done through diligence (and money spent), the relationship with the existing management team or shareholders throughout the process, their ability to pay or finance a deal by understanding the buyers' financial capabilities and their track record in consummating similar transactions. All of these points of contact and relevant information will influence or at any rate impact the seller's decision on which offer to accept.

The final stage of the sale process is the negotiation phase, which, in the best case scenario, can be entered with more than one buyer. At this stage, both legal and financial advisers engage directly with the buyers and their respective advisers to try to agree on price and the open terms of the contract. Maintaining competitiveness at this stage is challenging (you may have to produce alternate schedules for the bidders or duplicative teams and closely monitor the daily progress with each potential buyer), but ideally a negotiation can be performed with a couple of buyers in parallel. If this competitiveness is achieved, financial advisers will create a dynamic in which buyers are more willing to make concessions or accommodate sellers' requests to become the winning party.

The vast majority of the items to negotiate at this stage revolve around the open legal terms in the PA (and, if applicable, the SHA). The PA includes business as well as legal terms that require both the active participation of the financial and legal advisers. For example, some key open business items are frequently the purchase price adjustments and the definitive deal structure (e.g., percentage equity to be sold, future options to sell the remaining equity, earn-outs, among others). At the end of the day, both advisers (financial and legal) will try to determine the amount of risk that a seller will be exposed to by signing the PA, both between signing and closing of the transaction and particularly after closing. These risks can have a direct economic impact on the seller as they may represent purchase price adjustments (that can be in favour or against the seller) and future indemnifications. They may also impact closing certainty. In comparing and evaluating proposals received from potential buyers, it is of uttermost importance to quantify the potential impact of the

5 For transactions with all or part of the consideration payable in stock of the buyer or its affiliates, the role of the investment banker is significantly enhanced, including to ensure that the valuation of the issuer is appropriately measured against the valuation of the target. That includes a significant reverse due diligence exercise (unless the issuer is publicly traded).

proposed legal terms. At this stage, it is the financial and legal M&A advisers role to assess and recommend to the seller's board or shareholders a path forward based on the outcome of the process and the thorough analysis of all the offers received.

Furthermore, in M&A transactions that involve a merger between two parties, an acquisition with stock consideration or a partial acquisition (not 100 per cent of equity), in which the parties involved remain as shareholders of the existing or combined company, issues around governance become an important part of the negotiation. Negotiations around governance are usually documented in a SHA and typically include, among other things: board of directors' composition and representation, appointment of key management roles (i.e., CEO, CFO), transfer of shares and liquidity alternatives, budget and business plan approvals, or supermajority or veto rights for key decisions. Having the right set of governance terms in place allows a seller to protect its existing interest in the company and maximise value at the time of a future sale of its remaining interest. Both financial and legal M&A advisers will lead the negotiations of the key terms in the SHA. For financial advisers, maintaining multiple buyers interested at this stage of the process is absolutely vital as a negotiation tactic and is usually crucial to achieve a successful outcome for clients.

While the role of a financial adviser in an M&A sell side process described throughout this section is based on a typical sale auction process commonly used when selling a company, many M&A deals get done through processes that for different reasons differ from what we have laid out here. One of the most relevant pieces of advice a client will get from its financial advisers is precisely how to tailor a sale process to attend to the specific shareholders' objectives, the universe of potential buyers, the timing to get a deal done, among other decisive factors where the advisers bring their expertise to the table to provide unique context and tailored advice to every client.

Part III

New Transaction Dynamics and Evolving Trends in Latin America

7

Public M&As, Hostile Takeovers and Shareholder Activism

Francisco Antunes Maciel Müssnich, Monique Mavignier and Ana Paula Reis[1]

Historically, stock markets in Latin America have shown much lower trading volumes than their counterparts in developed countries. With businesses driven primarily by family groups,[2] investment funds and entities controlled by local governments, for most of the population trading shares was, and to a certain extent still is, a distant reality.

At the turn of the millennium, legislation and regulatory reforms brought about a dramatic change in that reality for some Latin American countries. In 2008 and 2009, for example, propelled by the Stock Market Law of 2006,[3] the Mexican National Banking and Securities Commission (CNBV) undertook a process of internal and regulatory restructuring that, together with new legislation, made the Mexican securities market more accessible, attractive and transparent, overcoming the crisis it faced in the 1990s. On 23 August 2015, the market value of the Mexican stock market hit US$478.8 billion, exceeding the Brazilian stock market, which traded $471.6 billion on that day.[4]

Brazil's story is much like Mexico's. After legislative and regulatory reforms,[5] in 2007 alone, 64 companies were listed on B3 SA – Brasil, Bolsa, Balcão (B3), formerly known

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2 ARMOUR, John; JACOBS, Jack B. and MILHAUPT, Curtis J. *The Evolution of Hostile Takeover Regimes in Developed and Emerging Markets: An Analytical Framework*. Vol. 52, N.º 1, 2011, pp. 273–274.

3 Ley del Mercado de Valores of 2006, published in the Diario Oficial de la Federación on 30 December 2005. The legislation was updated in 2007, 2014, 2018 and 2019. Available at https://www.cnbv.gob.mx/Normatividad/Ley%20del%20Mercado%20de%20Valores.pdf. Accessed on 8 September 2020 at 7:30 a.m.

4 3 'Bovespa deixa de ser maior bolsa da América Latina, superada por México'. *O Globo*. São Paulo. 23 September 2015. Available at: http://g1.globo.com/economia/mercados/noticia/2015/09/bovespa-deixa-de-ser-maior-bolsa-da-america-latina-superada-por-mexico.html. Accessed 5 September 2020 at 5:00 p.m.

5 Notable contributions to the reform include Law 10.303 (31 October 2001), which made the Comissão de Valores Mobiliários – CVM an independent government agency linked to the Ministry of the Treasury, having its own legal personality and assets and financial and budget autonomy, with status as an independent administrative

as BM&Fbovespa. That milestone may be matched or even exceeded in 2020, given that, by August of 2020, more than 45 IPOs were registered and plenty more were in the pipeline.

Nonetheless, most stock markets in Latin American countries are still developing and suffer from lack of depth and poor liquidity. The development of the equity capital markets in these countries would not only be relevant to foster the local economy, but could also represent a significant increase in M&A transactions involving public companies.

This article discusses three key components of public company activity, namely (1) IPOs and dual listings, (2) hostile takeovers and (3) shareholder activism, with the hope of providing some insight as to the current state of affairs in Latin America and expected trends for the near future. This article will heavily focus on Brazil, as one of the few markets in the region with sufficient depth and liquidity to offer critical mass of actual examples and dynamics on these issues.

Initial public offerings and dual listing

When a window of opportunity opens and the market timing is ideal – in other words, when management and the controlling shareholders believe that the cost of capital raised by issuing shares will be less compared to other types of financing, especially traditional financing involving banks – companies will turn to the equity markets to raise money through public offerings of shares.

When considering an initial public offering, market timing cannot be assessed in isolation. Aside from technical market issues, the decision to go public involves questions that depend on the company's owners (such as their inclination to assume risk), and the costs of legal and regulatory compliance in the country where the IPO will be made, among other factors.

Just like in 2007, Brazil in 2020 appears to have perfect market timing for companies to raise money in the equity market. As shown by data from Brazil's securities regulator, the Securities and Exchange Commission (CVM), the queue of companies that intend to go public this year continues to grow, and currently stands at almost 50 companies from all sectors, including the real estate sector, which alone accounts for more than 12 applications for registration of public offerings.[6]

Not only is the quantity of offerings impressive, but for the first time Brazilian start-ups are in the process of listing on the B3. Such listings are common in the US and Chinese equity markets, where businesses in the initial stages of their development are financed by venture capital and private equity funds, which use the stock market to allow investors to exit the venture.

authority, whose senior personnel are appointed for fixed terms and are not removable at will; CVM Instruction 323 (19 January 2000) – types of abuse of control and serious infractions; CVM Instruction 333 (6 April 2000) – illegal transactions on the securities market; CVM Instruction 358 (3 January 2002) – disclosure of material facts; CVM Instruction 361 (5 March 2002) – procedure for tender offers for shares in public companies; CVM Instruction 367 (29 May 2002) – declarations by persons elected to the board of directors of public companies); CVM Instruction 380 (23 December 2002) – procedures for trades on stock exchanges and over-the-counter markets made via internet; and CVM Instruction 390, (8 July 2003) – trading in their own shares by public companies by means of trades in options.

6 Available at: http://sistemas.cvm.gov.br/?ofertasdist. Accessed 5 September 2020 at 6:20pm.

In Brazil, however, the phenomenon is rare. Most of the time, startups wait until they have greater scale and maturity, and then try listing in the United States. PagSeguro and Stone are good examples: the former made its IPO on the New York Stock Exchange and the latter on Nasdaq.

From 2018 to 2019, 12 Brazilian companies launched IPOs.[7] Five opted for the New York equity markets: XP, Afya Educacional, Stone, PagSeguro and Arco Educação.[8] PagSeguro, a payment service provider, raised around US$2.27 billion in its IPO on Nasdaq. The offering was the largest any Brazilian company had made since BB Seguridade went public in Brazil in 2011, and the largest on Nasdaq since Snap's IPO in March 2017.[9]

Given an extremely liquid market and low interest rates, it seems Brazil's startups have decided to launch their IPOs, transforming the B3 into a Brazilian Nasdaq, which is favoured by technology and internet companies. As at October 2020, more than five tech startups had filed the prospectus for their IPOs with the CVM.[10]

As the equity markets in the region become more mature, the social and economic transformations that occur in a globalised and increasingly competitive world demand a reconsideration of local legislation, such as the rules on multiple voting shares. For decades, good corporate governance supported the 'one share, one vote' model, but in recent years there has been a strategic change in global business, and many jurisdictions, with different legal systems, have departed from the absolute application of the one-to-one rule.

In Argentina, for example, a company's by-laws can give each common share up to five votes. Once a company has obtained authorisation to make an initial public offering, however, it can no longer issue 'super voting' shares (article 216, Law 19550, the Ley de Sociedades Comerciales).

Conversely, Brazilian corporations are not permitted to issue multiple voting shares under local corporation law. The Brazilian ban on multiple shares was initially established in 1932 by Decree-Law No. 21,536/1932.[11] This was repeated in Decree-Law No. 2,627/1940[12] and the prohibition is still present in the current Brazilian corporation law (Law No. 6,404/1976).[13]

Multiple voting shares are common in the United States. For example, as a means to avoid pressure for short-term results, Facebook, LinkedIn, Groupon, Google and other

7 The other seven are Banco Inter, Hapvida Participações and Notre Dame Intermédica (in 2018) and Grupo SBF, C&A Modas, Banco BMG and Vivara (in 2019).

8 'Ações de brasileiras em Nova York operam bem acima de seus preços de estreia na bolsa'. *Valor Investe*. 8 July 2020. Available at: https://valorinveste.globo.com/mercados/internacional-e-commodities/noticia/2020/07/08/acoes-de-brasileiras-em-nova-york-operam-bem-acima-de-seus-precos-de-estreia-na-bolsa.ghtml. Accessed 8 September 2020, at 10:00 am.

9 PagSeguro, which belongs to UOL, a Brazilian content, technology and digital services company, raised $2.3 billion in its IPO in New York. *Bloomberg*, 24 January 2013 edition.

10 The two most recent prospectuses were filed by Vittia, a fertiliser and biological pesticides company, and the laser waxing company MPM Corpóreos. Applications to register offerings have also been filed by e-commerce site Enjoei, real estate rental platform Housi and Mosaico, which owns e-commerce content sites Zoom, Buscapé and BondFaro.

11 Article 1, Paragraph 4, of Decree-Law No. 21,536/1932.

12 Article 80, Sole Paragraph, of Decree-Law No. 2,627/1940.

13 Article 110, Paragraph 2, of the current Brazilian corporation law.

Silicon Valley names resorted to dual class shares in their IPOs, giving the founding shareholders enhanced voting powers, sometimes up to 150 times greater than those given to new investors. The reasoning behind the dual-class model is that the founding shareholders are those who are most interested in, and committed to, the company's long-term success. Silicon Valley has thus favoured a system in which there are two groups of shares: Class A shares, which are subject to the proportional voting system and are freely traded on the market, and Class B shares, which carry super voting rights and are held by long-term investors. Class B shares can be traded on the market, but if they are, they lose their super voting rights.

At present, provisions like Section 313.00 of the NYSE Listed Company Manual prohibit corporate actions or issuances that could disparately reduce or restrict the voting power of publicly traded common stock, such as the issuance of super voting stock. The provision does, however, generally allow shares with differentiated voting rights to be issued in the following scenarios, among others: prior to or as a result of an IPO; after an IPO has been made, as long as the new shares have the same characteristics as existing shares; the issuance of lower-vote stock; pursuant to certain hostile takeover defences, such as US poison pills; and upon de-listing.

Various jurisdictions have converged in offering super voting powers as a kind of 'reward' for loyalty or entrepreneurship to shareholders that are long-term investors in the business. Although it may seem strange under the 'one share, one vote' rule, giving greater weight to the vote of those who devote more time and money to the business, can be a beneficial solution for companies that face financial problems or that need their founders' drive to continue growing.

To understand the benefits of multiple voting for the economy, imagine a start-up or family business that is looking for investors to finance one of its projects. The founders do not want to sell their shares since – within the implacable logic of article 110, Section 2 of Brazil's Corporations Law – they would lose their control over the company. If multiple voting rights were allowed under Brazilian law, so that political power over the company could be dissociated from economic power, it would be much easier for such start-up or family business to welcome new investment. The investors rely on the founders' know-how and expertise and are ultimately interested in the profit that their investment can generate. Paul Rodel makes just this point: 'The goal of this structure is to make it possible for the company to raise capital by offering shares on public markets without sacrificing the control of visionary insiders who are focused on the long term.'[14]

On the other hand, there are jurists like Nelson Eizirik (who, despite asserting categorically that '[i]n Brazil, the legislation on companies does not accept multiple voting rights')[15] recognises that '[t]he concept of "one share, one vote" is beginning to show signs of weakening, because of the success of companies that have adopted multiple voting shares'.[16]

14 Paul Rodel. 'Dual class share voting structures for listed companies: are they here to stay?' Rome: Securities Law Committee - IBA Annual Conference, 19 July 2018, pp . 1–2.

15 Nelson Eizirik. *A Lei das S/A* v.2, 2.ed. São Paulo: Quartier Latin, 2015, p. 176. Our translation

16 Nelson Eizirik. *A Lei das S/A* v.2, 2.ed. São Paulo: Quartier Latin, 2015, p. 176 (footnote 6). Our translation.

Relaxing the 'one share, one vote' principle is not a threat if it is introduced with certain safeguards, such as maximum voting differentials, limitation of share classes, sunset clauses and mandatory corporate governance measures. In dual voting structures, it is expected an optimal arrangement between investors and founders. Investors who acquire dual class shares companies are willing to accept a corporate governance framework that is exposed to potential agency costs, while founders can strike a deal that presents an optimal level of voting differentials and economic benefits for each share class, with transparency and active involvement of shareholders in the decision.

In Brazil, corporate governance practices have significantly improved in the last 20 years[17] and various instruments and remedies are available for the protection of minority shareholders and investors, including, for example, the obligation of companies listed in Novo Mercado to have a Board of Directors composed of at least two directors or 20 per cent of members who qualify as independent directors (whichever is greater), with unified term of office of at most two years.

Despite its proscriptive legislation, Brazil may be closer to adjusting to international standards than it might seem. There is currently a bill before Brazil's Congress[18] – an initiative of the Ministry of the Economy in partnership with market participants, that would amend Law 6404/1976 (the Corporations Law) to include a new article 110-A, making it possible to create one or more classes of common shares with multiple voting rights, within certain limits.

A potential change in the Brazilian legislation would be welcome not only as an escape valve available to companies in financial difficulty, or to ensure that business' founders will remain in the company, but above all because it would bring Brazil in line with the global trend. Multiple voting rights represent an opportunity for companies to receive new investment in an effective, more efficient way.[19]

Beyond the multiple voting discussion, there is evidence of a desire by the Brazilian retail equity investors for a broader supply of attractive stocks in the Brazilian stock market. In August 2020, the CVM issued CVM Resolution 3, making it easier for Brazilian investors to acquire Brazilian Depositary Receipts (BDRs), certificates traded on B3 that represent shares issued by foreign companies traded in other countries. The certificates may also be backed by debt securities traded in other countries and issued by foreign companies or Brazilian companies registered with the CVM, shares issued outside Brazil by foreign issuers, or units in exchange-traded funds (ETFs) traded in foreign markets.

This new option for the general investing public reflects not only the desire of Brazilian companies listed outside the country to obtain access to local Brazilian investors, but also a growing demand for new types of investments. With exponential growth in the number of individuals investing in the stock market, it is natural to see demand for more diverse

17 Corporate governance practices, for example, improved notably in the 2004–2009 period, due to two main factors: (1) growth in Novo Mercado and Level 2, mainly through the entry of new companies with high corporate governance practices, and (2) improvement in the governance practices of the companies that were already listed, including in same cases migration to a higher listing level.

18 Drafted by Nelson Eizirik, Luiz Alberto Colonna Rosman and Francisco Antunes Maciel Müssnich.

19 Note that documentation, negotiations and terms of dual structures tend to be effective but also more complex.

investments to meet different investor profiles. As at August 2020, B3 had 2,958,422 individual investors, a significant increase from 557,109 individual investors in 2015.[20]

This sudden increase in the number of individual investors is also the result of a favourable scenario created by cuts in the Selic rate – the basic interest rate in the Brazilian economy – which in 2020 hit 2 per cent per year, the lowest in Brazil's history and close to the United States's basic interest rate. This new reality has reduced earnings from the more conservative investments that Brazilians generally prefer, giving a significant boost to the equity market.

The high point hit by the Mexican stock market on 23 August 2015 has not been translated in a sustained level of growth of the market in the following years and the Brazilian stock market continues to be the largest in Latin American. Brazil is thus unique, with legislation and regulations designed to accommodate transactions and trading in listed companies that is quite rare in its neighbouring countries. This has helped finance the inorganic and accelerated growth of Brazilian listed companies. Some sectors, such as real estate and technology, have experienced a considerable concentration in the past years resulting from multiple M&A transactions entered into by listed companies using proceeds from IPOs, follow-ons and other market transactions.

Hostile bids and takeover defences

In economic crises such as the one brought on by covid-19,[21] widely held companies tend to become the target of hostile takeovers by others that had ample capital prior to the crisis (meaning the unsolicited offer for the acquisition of one company (called the target company) by another (called the raider) that is accomplished by going directly to the company's shareholders or fighting to replace management to get the acquisition approved).

In Latin America, including Brazil, hostile takeovers are still rare because most public companies have a controlling shareholder or controlling group.[22] Amid political and economic uncertainties, it is not possible to assert with any conviction that the Brazilian and other regional markets are converging towards a system of dispersed control, as defined by Berle and Means.[23]

However, the market and practitioners cannot ignore the fact that the approximately 52 listed companies in Brazil that do not have defined control can become the target of competitive tender offers, capturing market and media attention, and frequently experiencing unprecedented hikes in the price of their stock.

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20 B3's Individual Investor Profile History (Histórico de Perfil dos Investidores Pessoas Físicas), available at: http://www.b3.com.br/pt_br/market-data-e-indices/servicos-de-dados/market-data/consultas/mercado-a-vista/ historico-pessoas-fisicas/. Accessed 5 September 2020 at 4:30 pm.

21 See Chapter 1 of this guide for further analysis of the impact of the covid-19 pandemic on M&A transactions in Latin America.

22 According to the CVM's market bulletins, available at http://www.cvm.gov.br/publicacao/boletimmercado.html, the number of companies without a defined controlling shareholder does not show a linear progression: in 2017, there were 59; in 2018, 52; and in 2019, the number grew once again, to 58.

23 BERLE JR., Adolf A., and MEANS, Gardiner C. *The Modern Corporation and Private Property*. New Brunswick, Transaction, 2010, p. 38.

Furthermore, despite their small number, every dispute that arises in connection with M&A transactions involving listed companies, and the decisions made in connection with those disputes, tends to become emblematic, and a reference for the entire market.[24] In more mature and deep markets with a tradition of corporate litigation rooted in common law, hostile takeover and other M&A-related litigation is prevalent. In fact, that healthy body of judicial precedent is what has defined the law of public company M&A in states like Delaware, which inform considerations that Latin American regulators and market participants adopt, even if somewhat modified and adapted.

In Brazil, one of the largest hostile takeover processes began with the admission of Eletropaulo Metropolitana Eletricidade de São Paulo SA to the Novo Mercado listing segment in 2017,[25] at which time all of its shares of capital stock became common shares (in accordance with the listing segment's rules), dispersed among investors in the company. At the end of the same year, Eletropaulo showed interest in making a public offering of shares, as one of the alternatives available for financing its operations and the development of its business.[26]

In the absence of defined control in Eletropaulo, on 5 April 2018,[27] Energisa S.A. made its first voluntary tender offer to acquire all of the shares in Eletropaulo. The dispute for control of Eletropaulo was fought between Energisa SA, Neoenergia SA[28] and Enel Brasil Investimentos Sudeste SA The latter ultimately acquired Eletropaulo, in an auction held on 4 June 2018.[29] The competitive process not only resulted in exponential increases in the

24 The history of hostile offers in the Brazilian market is scanty: in addition to the cases discussed in this article, in 1971, Macrossul tried to obtain control of Sulbanco, but failed; in 1978, after the current Brazilian Corporations Law had come into effect, Luz Cataguazes made a public tender offer for control of CEMIG; Perdigão's frustrated attempt to gain control of Sadia occurred in 2006; and the hostile takeover of GVT by Vivendi occurred in 2009. (CARVALHOSA, Modesto. *Comentários à Lei de Sociedades Anônimas*, 4ª ed., vol. 4: tomo II, São Paulo: Saraiva, 2011, p. 250); Cataguazes and CEMIG (CARVALHOSA, Modesto. *Comentários à Lei de Sociedades Anônimas*, 4ª ed., vol. 4: tomo II, São Paulo: Saraiva, 2011, p. 251); Sadia and Perdigão (Caso Sadia-Perdigão é sinal de evolução do mercado, *Valor Econômico*, 24 July 2006 edition); Vivendi and GVT (Vivendi surpreende a Telefônica e acerta a compra do controle da GVT, *Estadão*, 14 November 2009 edition).

25 Statement of Material Fact, Eletropaulo Metropolitana Eletricidade SA, 12 September 2017: admission of the company to the Novo Mercado segment: http://siteempresas.bovespa.com.br/consbov/ArquivoComCabecalho.asp?motivo=&protocolo=579257&funcao=visualizar&Site=C.

26 Statement of Material Fact, Eletropaulo Metropolitana Eletricidade SA, 29 November 2017: public offering of shares:http://siteempresas.bovespa.com.br/consbov/ArquivoComCabecalho.asp?motivo=&protocolo=587911&funcao=visualizar&Site=C.

27 Statement of Material Fact, Eletropaulo Metropolitana Eletricidade SA, 5 April 2018: public offering of shares: Public Tender Offer for Common Shares in the Company made by Energisa S.A.: https://www.rad.cvm.gov.br/ENET/frmExibirArquivoIPEExterno.aspx?NumeroProtocoloEntrega=607093.

28 Statement of Material Fact, Eletropaulo Metropolitana Eletricidade SA, 5 April 2018: public offering of shares: Public Tender Offer for Common Shares in the Company made by Neoenergia SA: https://www.rad.cvm.gov.br/ENET/frmExibirArquivoIPEExterno.aspx?NumeroProtocoloEntrega=611848.

29 Statement of Material Fact, Eletropaulo Metropolitana Eletricidade SA, 04/06/2018: result of the auction for acquisition of control of Eletropaulo: https://www.rad.cvm.gov.br/ENET/frmExibirArquivoIPEExterno.aspx?NumeroProtocoloEntrega=626969.

trading price of shares in the target company, as shown in the following table, but resulted in enhanced regulation and competition without precedent in the Brazilian market.

Variation in trading price of eletropaulo shares during the competitive process[30]	
Date	Price
12 September 2017	BRL 16.01
4 April 2018	BRL 19.27
4 May 2018	BRL 34.17
4 June 2018	BRL 44.76

More recently, in March 2020, Eneva announced a proposal to merge with AES Tietê, a step that would have required the approval of the shareholders of both companies, Brazil's anti-trust authority, CADE, and the National Electrical Energy Agency – ANEEL.[31] In April 2020, AES Tietê's board of directors announced it had rejected the proposal, which was deemed to be hostile.[32] In addition, AES Holdings Brasil Ltda (AES Tietê's controlling shareholder and the holder of a majority of the common shares in the company, although it does not hold a majority of the company's capital) stated in a letter sent to the company's management that the offer 'could not be implemented without the approval of a majority of the holders of common shares in the Company'.[33] Given the potential dispute over the rights of AES Tietê's preferred shareholders arising out of the fact that the company is listed on B3's level 2 corporate governance segment, Eneva opted to withdraw its offer.[34]

Also, in 2020, Gafisa began a hostile takeover process to acquire Tecnisa, in which a merger was the first alternative, prior to a voluntary tender offer for control of the company.[35] The shareholders with more sizeable holdings in the target mobilised, however, and worked together to convince the other shareholders to block the transaction Gafisa hoped to achieve. According to a source within Tecnisa, the group opposing Gafisa's offer represented about 45 per cent of the votes against the transaction.

The dispute between Gafisa and Tecnisa is not yet over. Indeed, the episode is a clear example of how companies with dispersed ownership concern themselves with developing techniques to defend against different types of hostile takeovers – whether at the management's initiative, or due to listing requirements. In the *Gafisa/Tecnisa* case, Tecnisa's by-laws provide that any shareholder that attains a holding of 20 per cent or more of the company's capital must, within 60 days, make a public tender offer to acquire the shares

30 Source: http://www.b3.com.br/pt_br/market-data-e-indices/servicos-de-dados/market-data/cotacoes/.

31 Statement of Material Fact, Eneva SA, 1 March 2020: proposed business combination with AES Tietê: https://www.rad.cvm.gov.br/ENET/frmExibirArquivoIPEExterno.aspx?NumeroProtocoloEntrega=741928.

32 Statement of Material Fact, AES Tietê Energia AS, 19/04/2020: board's decision – proposed business combination: https://www.rad.cvm.gov.br/ENET/frmExibirArquivoIPEExterno.aspx?NumeroProtocoloEntrega=755135.

33 Statement of Material Fact, AES Tietê Energia SA, 20/04/2020: letter from controlling shareholder: https://www.rad.cvm.gov.br/ENET/frmExibirArquivoIPEExterno.aspx?NumeroProtocoloEntrega=755192.

34 Statement of Material Fact, Eneva SA, 21 April 2020: proposed business combination with AES Tietê: https://www.rad.cvm.gov.br/ENET/frmExibirArquivoIPEExterno.aspx?NumeroProtocoloEntrega=755388.

35 Tecnisa se articula para barrar a Gafisa. *Valor Econômico*. 27 August 2020 edition.

held by all other shareholders. This defence tactic is commonly referred to among Brazilian professionals as a poison pill, which is more sobriquet than a technical name, given the conceptual differences between the Brazilian version and the US heavily used and broadly litigated instrument of the same name.[36]

Anti-takeover measures can be classified as preventive actions or counteractions, depending on when they are undertaken.[37] Preventive actions are taken prior to any attempt at a hostile takeover, and are designed to protect the company against unwanted new shareholders with significant holdings, such as poison pills, staggered boards or poison puts (provisions in debt instruments granting the right of the instrument holder to sell the bonds back to the target). Counteractions, in turn, are taken after a hostile takeover attempt has been initiated, on an ad hoc basis.[38] In both cases, anti-takeover measures can take different forms, and can be implemented through the company's by-laws, by contract, or through institutional devices, by creating entities, sometimes with their own legal standing.[39]

To exemplify the difference in scope, consider that more than 15 poison pills implemented by listed companies in the United States in the months of March and April 2020, in response to the adverse impacts of the covid-19 pandemic.[40] The same did not occur in Latin American countries, which is not surprising given the small number of hostile takeovers it has experienced.

Brazilian pills generally involve standard by-law provisions,[41] imposing an obligation to make a public tender offer to all shareholders whenever any shareholder's holding reaches a certain threshold, such as 15 per cent, 20 per cent or 25 per cent of the company's float.[42]

In addition, Brazilian companies' by-laws tend to have accessory provisions designed to ensure the effectiveness of their main defensive clauses, particularly relating to instances in which the public tender offer provided for in the by-laws is required to be made. Various companies' by-laws, for example, provide that shareholders that fail to comply with the

36 A poison pill in the United States essentially consists of plans granting shareholders the right to acquire shares at a deep discount, effectively diluting the purchaser upon completing a hostile takeover.

37 CLARK, Robert Charles. *Corporate Law*. Boston / Toronto, Little Brown and Company, 1986, p. 571.

38 Some of the United States's most prevalent defences include the Pac-Man defence (where the target turns around and attempts a hostile takeover of the hostile buyer), the white knight defence (where the target is sold to a more desirable purchaser instead of the hostile buyer), the white squire defence (where a block of voting instruments is sold or issued to a friendly player), the crown jewel defence (where the most valuable assets of the target are sold to make it less desirable to the hostile buyer) or the greenmail defence (repurchasing stock in the target already held by the hostile buyer).

39 COMPARATO, Fábio Konder; SALOMÃO, Calixto Filho. *O Poder de Controle na Sociedade Anônim*a. 4 ed., Rio de Janeiro: Forense, 2005, p. 145.

40 Debevoise & Plimpton. Coronavirus Resourse Center. Exhibit A – Selected Recent Stockholder Rights Plans, 2020, p. 4. Accessed on 8 September 2020 at 11 am: file:///C:/Users/arsb/Downloads/20200409%20Rethinking%20Poison%20Pills%20Again.pdf.

41 NASCIMENTO, João Pedro Barroso do. Medidas Defensivas a Tomada de Controle de Companhias. São Paulo: *Quartier Latin*, 2011, pp. 150–151; GORGA, Erica. 'Changing the Paradigm of Stock Ownership: From Concentraded Towards Dispersed Ownership? Evidence from Brazil and Consequences for Emerging Countries.' 3rd Annual Conference on Empirical Legal Studies Papers. Abr. 2008, pp. 47–48.

42 CARVALHOSA, Modesto. As Poison Pills Estatutárias na Prática Brasileira: alguns aspectos de sua Legalidade. In: CASTRO, Rodrigo R. Monteiro; ARAGAO, Leandro Santos de. Direito Societário: Desafios Atuais. São Paulo: Quartier Latin, 2009, p. 25.

defensive provisions will have their shareholder rights suspended, as provided for in article 120 of the Brazilian Corporations Law. Others set forth maximum voting clauses or restrictions on voting by a single shareholder.[43] Standstill agreements are not commonly used, though, most probably due to the restricted role of company's management on hostile bids – management is required to opine, but may not contract on behalf of shareholders, who may choose to accept or not a hostile offer.

Even so, in companies having defined control, the controlling and the minority shareholders' views on how the company's business should be conducted may not be aligned, resulting in impasses on important decisions to be made at shareholders' meetings. In companies that have more dispersed capital, in which traditional control (50 per cent plus one share) does not exist, 'minority control' can arise, creating a situation where such conflicts are even more frequent, with significant shareholder initiatives opposing management. In such a context, activist shareholders can attract the spotlight, and sometimes take on a leading role in the company.

Shareholder activism

Activist minority shareholders are much more common in the United States and in Europe: evidence of shareholder activism in Latin America is still scarce, even in its largest economy, Brazil. Undoubtedly, the high concentration of share ownership contributes to the low level of activism in Brazil.

In the United States, shareholder activism has been studied in the context of Commercial Law since the last century. Authors like Black (1998),[44] Gillan and Starks (1998),[45] Karpoff (2001),[46] Partnoy and Thomas (2007)[47] and Coffee and Palia (2016)[48] demonstrate that shareholder activism has shown significant growth in that country,[49] generating different strategies, such as 'sell the company activism', 'return the cash activism', 'change the board activism' and 'operational improvement activism', implemented through tactics such as tender offers, proxy fights and 'wolf-packing'.

The role played by proxy advisory firms, which specialise in giving public recommendations on governance matters that will be submitted at shareholders' meetings, can have

43 As an example: Embraer S.A. and B3 S.A. - Brasil, Bolsa, Balcão.

44 BLACK, Bernard. S. 'Shareholder activism and corporate governance in the United States'. In: Newman, P.K., (Ed.) *The New Palgrave Dictionary of Economics and the Law*. Basingstoke: Macmillan – now Palgrave Macmillan, 1998, pp. 459–65.

45 GILLAN, Stuart. L. and STARKS, Laura T. 'A survey of shareholder activism: Motivation and empirical evidence'. *Contemporary Finance Digest*, 2 (3), 1998, pp. 10–34.

46 KARPOFF, Jonathan M. 'The impact of shareholder activism on target companies: A survey of empirical findings' (Working paper). University of Washington, 2001.

47 COFFEE, John C. and PALIA, Darius. *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*. Annals of Corporate Governance: 2016, Vol. 1: No. 1, pp 1-94.

48 See John C. Coffee Jr. & Darius Palia, *The Wolf at the Door: The Impact of Hedge Fund Activism on Corporate Governance*, 41 J. CORP. L. 545 (2016).

49 BRANTON. William W.; MCCAHERY, Joseph A. *Institutional Investor Activism: Hedge Funds and Private Equity, Economics and Regulation*. Oxford University Press, 2015, p. 40.

a decisive effect on the vote cast by investors, making it possible for activists to attract a greater number of shareholders to their position.

In Brazil, the Corporations Law provides for certain positions in a company's management to be held by its minority shareholders, who, as investors in the business, have a legitimate interest in monitoring the conduct of the company's affairs, taking part in decisions, and, if necessary, inspecting the management of the company by appointing members of the fiscal council. Against such a legal backdrop, companies that hinder minority shareholders by failing to follow good corporate governance practices compromise their image in the market and in the media in general.

Since the 1990s, institutional investors in the Brazilian market, especially pension funds, seem to have adopted a strategy of ensuring that they have a strong presence in the share ownership structure, with constant monitoring of companies' business and of governance in the companies' internal structures.[50]

More recently, shareholder activism has enabled investors who believe that the future lies in sustainable business to use their influence to require officers and directors to ensure that their company's practices are consistent with sustainability and positive social impact, resulting from the adoption of environmental, social, and corporate governance principles (ESG). Institutional investors such as BlackRock have publicly adopted strategies that prioritise investment in companies committed to ESG.[51]

Notwithstanding the positive aspects of shareholder activism indicated above, one should always bear in mind that activists do not necessarily aim at long-term investments or have a true capital commitment with the company they invest. Empty voting, as it has been called worldwide when the economic interest in the company does not reflect, proportionally, the voting power, has been experienced in Brazil, and may lead to decisions not necessarily aligned with a company's and its shareholders' long-term views.

With a view to aligning Brazilian practices with those of the member countries of the Organisation for Economic Cooperation and Development, the CVM issued CVM Instruction 627/2020. The new rule sets out a scale of percentage holdings that minority shareholders must have in order to seek reparation for losses caused by management, through actions such as: bringing a derivative action against members of management, calling a general meeting of shareholders, requiring information from the Fiscal Council and requesting information from members of management.

Although the change is positive in the sense that it promotes shareholder activism, the CVM has jurisdiction only over matters involving corporate law and the securities market, with powers to bring administrative enforcement proceedings and impose sanctions against

50 CRISÓSTOMO, Vicente Lima e González, Eleuterio Vallelado. 'Possível estratégia de ativismo de fundos de pensão no Brasil'. *Revista Econômica Contemporânea*, Rio de Janeiro, Vol. 10, 2006: pp. 139-155. Available at https://www.scielo.br/pdf/rec/v10n1/06.pdf.

51 For example, Larry Fink, Chair of the Board of Directors and CEO of BlackRock, recently wrote a letter to BlackRock's investors, stating that investment awareness is changing rapidly, and he believes that the world is on the brink of a fundamental reshaping of finance toward ESG objectives. Available at: https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter.

parties that violate CVM regulations, the Brazilian Corporations Law, or the Capital Markets Law (Law 6385/1976).

Even so, the CVM's enforcement efforts are becoming one of the main ways shareholders have found to obtain reparation when their rights are infringed. Every year, the CVM brings numerous enforcement proceedings against individuals and companies. In the second quarter of 2020 alone, for example, the total amount of fines issued by the CVM was 9.58 million reais, against 20 accused parties. In 2019, fines imposed by the CVM came to more than 1 billion reais.[52]

Nonetheless, given the CVM's limited scope of action, many investors and shareholders still must turn to the courts to recover losses caused by members of management and controlling shareholders who act contrary to the law. In fact, Brazil's courts have held that the civil liability of management and of controlling shareholders can be dealt with in the same way, since both are subject to the same principles established in the Constitution with respect to the country's economic order.[53] Controlling shareholders are therefore subject to the same action in civil liability provided for in the Brazilian Corporations Law with respect to members of management.

It should also be noted that the lack of shareholder activism can be harmful not only to companies and shareholders exposed to wrongful practices by management and controlling shareholders, but to society at large. Shareholder absenteeism is a common phenomenon in the Brazilian market. In fact, the *Petrobras* case is an excellent illustration, and shows that promoting activism in defence of minority shareholders should be a priority in Brazil.[54]

Brazil's recent history has been tarnished by business scandals, with criminal charges and sentences involving individuals and institutions from both the public and the private sectors. These episodes have affected the value and credibility of some of the company's largest listed companies. As a solution, or at least a palliative measure, mechanisms for enforcement of Brazilian investors' rights is essential, given the general perception that the current legal regime is far from offering adequate means for the protection of investors.

It is precisely for this reason that the independence rules under the Novo Mercado listing regulation are so important. A company's board of directors should act as a counterweight to management, in order to ensure that the company's business is conducted in a independent fashion, by qualified managers, avoiding the need for the company and its investors to use the mechanisms that are available to obtain reparation of losses – and that aim is more likely to be realised in boards where there is a significant number of independent members.

52 Comissão de Valores Mobiliários – CVM. Relatório de Atividade Sancionadora CVM: 2º trimestre (abril-junho) 2020, p. 13. (CVM Enforcement Activities Report: 2nd quarter (April-June) 2020). Accessed 5 September 2020 at 2pm: http://www.cvm.gov.br/export/sites/cvm/publicacao/relatorio_atividade_sancionadora/anexos/2020/20200903_relatorio_atividade_sancionadora_2o_trimestre_2020_versao_resumida.pdf.

53 FRAZÃO, Ana. Função Social da Empresa - repercussões sobre a responsabilidade civil de controladores e administradores de S/As. São Paulo: Renovar, 2011, pp. 248-249.

54 GORGA, Érica. 'Considerar Petrobras vítima de corrupção é rasgar leis'. Folha de São Paulo, São Paulo, 14 August 2015 edition. Mercado. Available at: http://www1.folha.uol.com.br/mercado/2015/08/1668646-considerar-petrobrasvitima-da-corrupcao-e-rasgar-leis-diz-advogada.shtml.

In Brazil, there are no legal means to hold companies liable for disclosing false information to the market, differently from the class actions available in the United States, for example. Only controlling shareholders and management have liability, based on articles 117, 155, and 157 of the Corporations Law. Nonetheless, there is nothing to prevent opting for corporate arbitrations to deal with potential liability and reparation. Novo Mercado companies are required by the listing regulation, for example, to adopt arbitration as the means of resolving corporate disputes.[55]

Still, the use of arbitration to resolve disputes is not free from criticism and concerns. The main concern, certainly, is the supposed confidentiality of arbitral proceedings: in litigation that can involve hundreds of parties, to what extent can confidentiality be assured? And, above all, given the importance of the matters in dispute, to what extent is it appropriate for the market and for society to allow significant disputes to remain confidential? It is too early assert that the benefits of confidentiality outweigh the potential harm of concealing the matters in dispute and how they are decided.[56,57]

Conclusion

Mergers and acquisitions involving listed companies, together with shareholder activism, are inexorable movements that are intimately related to the development of a country's securities market. Although there is good reason to believe that a new wave of hostile takeovers and shareholder activism will be postponed until the public health situation and the market stabilise, there is also good reason to believe that businesses' M&A and corporate development divisions, banks, investment funds, and other market participants are currently working to identify potential targets and corporate governance structures to be developed through public markets.

In this context, discussions have been raised in some markets to evaluate the legal and regulatory models and, possibly, establish a dual voting system to allow structures that accommodate the concentration of power to founders or founding groups in certain industries, such as technology companies.

In Latin America, there would be no reason to be different: offering this type of alternative has become a requirement not to lose competitiveness of the listing environment for companies with high-growth potential, in a context of increasingly fierce competition. It has become urgent to bring this discussion to the context of the local markets, considering,

55 Article 39 of the Novo Mercado Regulation provides that the bylaws of companies listed on the segment must contain an arbitration clause requiring the company, its shareholders, the members of its management, and the members of its fiscal council (if any) resolve any and all disputes between them by arbitration before the Market Arbitration Chamber (CAM-B3).

56 CAM-B3 has recently launched an initiative to give greater publicity to decisions made by its arbitrators by means of summaries of their decisions available at: http://www.b3.com.br/pt_br/b3/qualificacao-e-governanca/camara-de-arbitragem-do-mercado-cam/ementario/.

57 Note to authors: please consider adding more focus on shareholder activism in the context of M&A transactions. There may not be much in the region, but the article could include the theory and mention a few examples, even if only showing early signs of activism. The recent Casino – Pão de Açucar – Exito dealings may be a good example to comment. We also understand that there are funds that have shown signs of activism in the context of M&A in recent years, such as Tempo Capital and Cartica Capital.

above all, the growing importance that those companies would have in their economic scenarios, and the need to maintain their competitiveness as compared to other main global financial centres.

Moreover, there can be no doubt that officers and directors of public companies will gain a considerable head start over their competitors by reviewing their corporate governance structures and reassessing measures to defend against hostile takeover bids.

Although the shareholding structures in most Latin American countries do not show much similarity to shareholding patterns in companies based in Europe and North America, the debates and disputes that arise in acquisitions of public companies have left a permanent mark on the legal and economic agendas of the jurisdictions in which they occur – not least because of the publicity that must by law be given to material issues involving public companies.

These public transactions are directly related to opportunities for companies to go public in local stock markets and, while they are in course, they are subject to active participation by shareholders, minority or not, in how the deal is conducted and whether (and how) a hostile bid will be fought off.

Increasingly, transparency, fairness, accountability, and corporate responsibility, especially in relation to ESG principles, will be given more weight by investors when deciding where to put their money. Because of these and other factors discussed in this brief review, corporate governance is taking on a prominent role both before and after companies go public, imposing itself on corporate agendas and becoming a priority for management.

8

Distressed Mergers and Acquisitions: Lessons from the Venezuela Experience

Fulvio Italiani and Giancarlo Carrazza[1]

Downturns in macroeconomic conditions and challenges resulting from political turmoil create an environment that tends to make traditional M&A transactions harder to conceive and consummate. However, there is plenty of experience around the world on distressed M&A - that is, transactions where the target is undergoing a significant negative period of performance and is at risk of bankruptcy, shutdown or other inability to operate under its existing model. This article will provide some examples of various triggers and features frequent in distressed M&A transactions, using the Venezuelan experience of the past decade.

Venezuela has had its fair share of distressed M&A activity in recent years owing to its well-known and continued political and economic crisis. But this surge in distress only began a few years ago as a result of the worsening of the economic crisis and the lack of alternative viable ways for business owners to exit the Venezuelan market.

We have extracted some lessons from our experience advising buyers and sellers in this growing distressed M&A scene and will try to translate these lessons into the description of the principal features of a Venezuelan distressed M&A deal, which we believe can be useful in other jurisdictions as they face moments of crisis.

Evolution of M&A in Venezuela

The decade that preceded Hugo Chávez's election to the presidency of Venezuela in 1998 was marked by traditional M&A activity and a wave of privatisations.[2]

1 Fulvio Italiani is a partner and Giancarlo Carrazza is an associate at D'Empaire.

2 Notable privatisations included: CANTV, Venezuela's largest telecom services provider in 1991 (the VenWorld Consortium, led by GTE Corporation (now Verizon), purchased 40 per cent of CANTV's capital for an amount of US$1.8 billion); Viasa, Venezuela's then flag carrier in 1991 (Iberia, together with Banco Provincial, purchased 60 per cent of Viasa's capital for an amount of US$145.5 million); and Sidor, Venezuela's largest steel producer in 1998 (the

The first years of Hugo Chávez's tenure (1999-2006), while politically unstable, were still marked by traditional M&A activity and the opening of some sectors to foreign investment. These years saw significant takeovers of large listed companies.[3]

From 2006 to 2013, the government nationalised several industries as part of its policy of reducing the influence of multinational corporations. These nationalisations were fuelled by a surge in oil prices, and were carried out either through outright nationalisations (in many cases without compensation to the owners of the nationalised businesses or assets)[4] or negotiated M&A transactions (i.e., mergers and nationalisations (M&Ns)).[5]

The year 2014 was marked by political upheaval, and Venezuela has remained politically and economically unstable to this day as a result of the collapse of oil prices and Venezuela's

Amazonia Consortium, a group of Latin American steel producers led by Argentina's Siderar, purchased 70 per cent of Sidor's capital for US$1.2 billion). This decade also saw the opening of the oil industry to private investment – *apertura petrolera* – through the award of strategic associations, profit-sharing and operating agreements to international oil and gas companies.

3 Notable takeovers and takeover attempts included: La Electricidad de Caracas (EDC), Venezuela's largest utility company in 2000 (AES Corporation purchased 87 per cent of EDC's capital through a US$1.66 billion unsolicited dual tender offer for the shares and ADRs of the company in Venezuela and the United States); AES then tried to acquire 43.2 per cent of CANTV's capital through a US$1.37 billion unsolicited dual tender offer in 2001, but AES withdrew the offer as a result of the September 11 attacks and CANTV's rejection of the offer ('AES Withdraws Its Bid For Venezuela's CANTV', https://www.wsj.com/articles/SB1005145018782374000); Digitel, a major mobile telecom operator in 2000 (Telecom Italia purchased 55.6 per cent of Digitel's capital in 2000, and then sold 100 per cent of its interest to Grupo Televenco in 2006 for US$425 million); and Mavesa, one of Venezuela's largest food manufacturers in 2001 (Grupo Polar, Venezuela's largest industrial conglomerate, purchased 100 per cent of Mavesa's capital pursuant to a US$480 million dual tender offer for the shares and ADRs of the company in Venezuela and the United States).

4 Notable outright nationalisations included: ConocoPhillips' stake in the Petrozuata, Hamaca and Corocoro oil projects (2006–2007); ExxonMobil's stake in the Cerro Negro oil project (2006–2007); Cemex's stake in its local subsidiary (2008); Sidor (2008) (several months after the announcement of the nationalisation of Sidor, the Venezuelan government and the shareholders of Sidor reached a settlement agreement in May 2009 that contemplated the payment of a compensation of US$1.97 billion); and Owens-Illinois's stake in its local subsidiary (2010). This wave of nationalisations led to a surge in the number of international litigation cases against Venezuela, many of which concluded with the issuance of multimillion-dollar awards that have been either settled or are now in the process of being enforced, mainly before US courts.

5 M&Ns were accomplished through a formal or informal announcement by the government of its desire to nationalise a company followed by a negotiation of the purchase of the company by the government using traditional M&A tools (due diligence, negotiation of stock purchase agreement and, in some cases, tender offers in the capital market). The transactions followed political pressure that induced shareholders to quickly reach the best possible deal they could get to avoid an outright nationalisation with a lower compensation (or no compensation at all). After the government had already showed that it would not think twice before carrying an expropriation, it is no surprise that many of these deals were closed. Notable M&Ns included: CANTV in 2007 (Verizon sold its entire stake in CANTV (28.5 per cent) to the Venezuelan government for US$572 million pursuant to a US$1.3 billion dual tender offer for the shares and ADRs of the company in Venezuela and in the United States. The announcement of the nationalisation of CANTV followed the joint offer by Telmex and América Móvil to purchase CANTV, pursuant to an unsolicited dual tender offer for the shares and ADRs of the company in Venezuela and in the United States; this offer was withdrawn by Telmex and America Móvil as a result of the nationalisation announcement); La Electricidad de Caracas (EDC) in 2007 (AES Corporation sold its entire stake in EDC (82 per cent) to the Venezuelan government for US$739 million following the announcement of its nationalisation. The purchase was made pursuant to a dual tender offer of the shares and ADRs of the company in Venezuela and the United States); and Banco de Venezuela, Venezuela's largest bank in 2009 (Banco Santander sold its entire stake in Banco de Venezuela to the Venezuelan government for US$1.05 billion).

oil production,[6] the political situation, deadlock and US sanctions. This situation has left the country with a strikingly smaller economy and internal demand for goods and services.[7] The government – now with emptier coffers – lost its appetite for nationalisations and M&Ns. This period has been marked by stringent price controls, resulting in significant shortages of most consumer goods, strict foreign exchange controls that criminalised black market foreign currency transactions (all the while, the official exchange rates were kept artificially low, creating huge gaps between the official rate and the black market rate) and one of the highest and most prolonged hyperinflation in contemporary world history.[8] As a result of these challenging conditions, several multinationals decided to exit the country. While some of them decided to shut down their operations in Venezuela, others decided to sell their operations to third parties, triggering a number of distressed M&A transactions.[9]

Triggers and principal features of distressed M&As in Venezuela

As mentioned above, the beginning of the recurrent distressed M&A activity in Venezuela can be traced to the beginning of 2014. We will try to describe the most influential causes that have triggered distressed M&A activity. We will then look into the principal features of distressed M&A deals in Venezuela.

Triggers

On the one hand, exiting Venezuela became necessary for many multinationals in recent years because of the challenges to operate a business in Venezuela (the 'operational trigger'). On the other hand, liquidating or winding down the business, or shutting down operations in Venezuela altogether, is unfeasible or raises significant risks and, therefore, the sale of

6 'Oil Industry Is Fading Away in Land of the World's Richest Reserves', https://www.wsj.com/articles/oil-industry-is-fading-away-in-land-of-the-worlds-richest-reserves-11599238961.

7 'Gross domestic product shrank from about $196 billion in 2013 to some $80 billion last year, smaller than that of Guatemala or Ethiopia'. See: 'Venezuela's Economic Collapse Explained in Nine Charts', https://www.wsj.com/articles/venezuelas-economic-collapse-explained-in-nine-charts-11553511601?mod=article_inline.

8 Given the critical economic situation of Venezuela, the government recently started to ease several government controls affecting the economy ('Maduro Gives Economy a Freer Hand to Keep His Grip on Venezuela', https://www.wsj.com/articles/maduro-gives-economy-a-freer-hand-to-keep-his-grip-on-venezuela-11580380203). The government repealed foreign exchange regulations criminalising foreign currency exchange transactions and the sale of goods and services in foreign currency. The Venezuelan economy has become informally dollarised; an increasing number of transactions are settled in US dollars, but banks remain shy from opening US-dollar-denominated accounts due to opaque regulations, and taxes and other duties are still payable in local currency exclusively. Price control regulations have not been enforced as much as in previous years, except for a few notable cases (in April 2020, the government enforced price control regulations against Polar, Plumrose and Coposa, three large food manufacturers). The government has also aggressively promoted imports by eliminating import tariff and duties. We have yet to see if these measures will be sustained in time and what effects, if any, will they have on M&A activity. For the time being, these measures do not appear to be part of a broader economic plan, but makeshift solutions aimed at easing social tensions caused by the deep economic crisis.

9 Notable M&A transactions during this period included: the sale of Plumrose's Venezuelan subsidiary (2014); the sale of Dana's Venezuelan subsidiary (2015); the sale of Bridgestone's Venezuelan subsidiary (2016); the sale of General Mills's Venezuelan subsidiary (2016); the sale of Pirelli's Venezuelan subsidiary (2018); the sale of Zurich Seguros by Zurich Insurance Group (2018); the sale of Seguros Caracas, Venezuela's largest insurance company, by Liberty Mutual (2019); and the sale of Cargill's Venezuelan subsidiary (2020).

the operations to a third party became the most viable alternative (the 'legal trigger'). These two triggers account for the increase in distressed M&A activity in Venezuela in recent years.

Operational trigger

Venezuelan businesses have become increasingly difficult to operate over the last years for a number of reasons.

While inflation had characterised Venezuela's economy for many years, the second half of the 2010s was marked by a record-breaking hyperinflation accompanied by a lack of public estimates and data by the Venezuelan government for many of those years (until recently, the Central Bank had plainly stopped issuing such estimates). Needless to say, hyperinflation has had pervasive effects on the management of Venezuelan businesses, ranging from increased difficulties in making sense of the entity's accounting (several multinationals deconsolidated their Venezuelan operations to isolate their adverse financial and accounting effects), coming up with suitable and viable solutions for employees' compensation (salaries in local currency quickly lost their purchasing power) or the virtual destruction of local currency financing options.

The strict foreign currency exchange system criminalised black market foreign currency transactions, while the government drastically reduced the offer of foreign currency through official auctions and kept the official rate artificially low. This situation, coupled with the collapse of oil prices, triggered one of the greatest currency devaluations in history. The huge gap between the official and black market rates causes significant accounting distortions.

The foreign currency authority virtually stopped accepting requests to remit dividends abroad at the official rate. This often left multinationals with no other option but to reinvest any profit they could generate into their Venezuelan operations to mitigate the hyperinflation's effect on the value of local currency profits.

Stringent price controls set a 30 per cent profit margin cap and did not allow companies to take into account most of their overhead costs and hyperinflation to calculate their profit. The government also fixed prices for certain goods, which were sometimes frozen over long periods of time, forcing companies to sell goods at a significant loss. Price control regulations were also used as a basis for recurrent and excruciating audits by government officials that, in some cases, ended with the imposition of fines, temporary closures of the business, seizures and criminal prosecution of key employees.

Labour freezes have remained in force for many years. Under Venezuelan law, employees cannot be unilaterally terminated by the employer without cause. Termination of employees for cause (such as theft, absenteeism) has become practically impossible because terminations must be approved by government officials (*inspectores del trabajo*), who rarely do so. Thus, terminations have to be achieved by negotiating enhanced termination packages with the employees to incentivise their resignation.[10] Union leaders, health and safety delegates

10 Fulvio Italiani and Carlos Omaña, 'Navigating a Corporate Crisis: Managing the Risks of Downsizing in Venezuela', in *The Guide to Corporate Crisis Management*, 2nd ed, 2019: p. 28.

and employees on maternity or sick leave are under special protection and may require tailor-made termination packages in exchange for their resignations.[11]

Decreases in the quality of life due to the adverse conditions in the country (hyperinflation, insecurity, food and medicine shortages, long-lasting blackouts or recurrent brownouts) make it harder for companies to retain much-needed talent, which prefers to leave the country seeking more stable environments. Often, key employees are based outside the country for these reasons, posing additional challenges for coordinating internal procedures and dealing with crucial meetings with government officials.

International and US sanctions pose additional challenges for operating in Venezuela, especially for companies owned by US multinationals. Day-to-day commercial or financial transactions clearly out of the scope of sanctions take much more time to close due to KYC and due diligence procedures, and in many cases are stopped from closing altogether out of excess of caution. US companies depend on the issuance of general or particular Office of Foreign Assets Control (OFAC) licences to continue operating, building uncertainty for long-time commitments in the country.

The cost-benefit analysis of operating in Venezuela owing to Foreign Corrupt Practices Act (FCPA) or similar regulations is also relevant to companies owned by foreign multinationals. These companies have to deploy strict compliance programmes and ensure management oversight of the entity's dealings owing to the levels of reported corruption in Venezuela.

The ever-present nature of the challenges of the Venezuelan political and economic environment makes multinationals spend an ever-growing amount of managerial time having to deal with such challenges. Similarly to the cost-benefit analysis of having FCPA compliance programmes, the trade-off between managerial time and profits for the headquarters becomes less convenient with the passing of time given the shrinking of Venezuela's economy and its near future uncertainty.

Notably, debt pressure is omitted as an operational trigger due to hyperinflation wiping out the companies' debt burden.

Legal trigger

From a legal standpoint, the main trigger for the sale of distressed businesses in this period of economic crisis is the lack of other viable alternatives to exit the country.

Under Venezuelan law, it is not possible to unilaterally liquidate a business as a way to exit the country.[12] As mentioned above, employees cannot be unilaterally terminated by the employer without cause, and voluntary liquidation is not a cause for the termination of employees under Venezuelan law.

In light of this, some multinationals have exited the country by permanently shutting down their operations in Venezuela while maintaining the legal vehicle, paying all labour

11 id.

12 Under the Code of Commerce's winding-down rules, the shareholders' may resolve to wind down a company for any reason, before the expiration of its duration as set forth in its by-laws, and designate one or several liquidators that will undertake all actions necessary to wind down the company. See Fulvio Italiani and Carlos Omaña, 'Restructuring 2019: Venezuela', in *Latin Lawyer Reference*.

obligations with their employees and debt with their suppliers.[13] However, in many cases, the shutdown has triggered a strong reaction from the government, including the criminal prosecution of key employees based in the country arguing economic destabilisation, boycott, labour breaches or otherwise. In addition, the government has the legal power to 'temporarily intervene' companies to 'protect employment'.[14] After these interventions, the government has started operating the businesses and even kept manufacturing the same branded products without the consent of the owner of the brand.[15]

Given the risks involved in a shutdown of the operations, the sale of the operations to a third party became an effective way to exit Venezuela.

Principal features

Out-of-court sale

One of the most salient features of distressed M&A activity in Venezuela is that it occurs outside of insolvency proceedings for two reasons. On the one hand, businesses have low amounts of debt mainly because local currency financing got diluted by hyperinflation, and the only significant foreign currency denominated debt is generally intercompany debt. On the other, the existing insolvency processes contemplated under Venezuelan law are old and ill-equipped to liquidate the insolvent company.[16] This causes the owner of the Venezuelan business to avoid the lengthy and uncertain insolvency proceedings and aim for an out-of-court sale of their businesses.

Type of buyer

The buyer of a distressed transaction in Venezuela typically has a considerable tolerance for risk and bets on a political or economic change. There are even private equity funds that are actively looking for opportunities and have shown interest in these types of divestitures, especially because they tend to be completed in exchange for little or no consideration,[17] which could be translated into sizeable profits come a more stable political or economic environment in the near future.

13 See 'Venezuela Takes Over Plants Left by U.S Firm Clorox', https://www.reuters.com/article/us-clorox-venezuela/venezuela-takesover-plants-left-by-u-s-firm-clorox-idUSKCN0HL2FW20140927; 'Is It the End? Venezuela Takes Over Kimberly Clark Operations', https://www.barrons.com/articles/is-it-the-end-venezuela-seizes-kimberly-clarkoperations-1468342351; 'Kellogg Pulls Out of Venezuela, Citing Its "Deterioration"', https://www.wsj.com/articles/kellogg-pulls-out-of-venezuela-citing-its-deterioration-1526419980.

14 Organic Labour Law, Article 145. Pursuant to this law, the Ministry of Labour has the power to designate an intervention committee, albeit including members to be designated by the shareholder, and delegate this committee with the power to manage the company. See Fulvio Italiani and Carlos Omaña, 'Navigating a Corporate Crisis', op cit, p. 28, footnote 7.

15 'Kellogg's to Take Legal Action Against Venezuela for the Improper Use of the Brand after Expropriation', https://www.brandsprotectionnews.com/en/kelloggs-to-take-legal-action-against-venezuela-for-the-improper-use-of-the-brand-after-expropriation/.

16 Proceedings may last from several months to several years. See Fulvio Italiani and Carlos Omaña, 'Insolvency Proceedings in Venezuela: A 19th Century Statute is Ill-Equipped to Navigate Current Times', in *Emerging Markets Restructuring Journal*, 2017, 4.

17 Fulvio Italiani and Carlos Omaña, 'Navigating a Corporate Crisis', op cit, p. 27.

In addition to private equity funds, typical buyers include family offices of high net worth individuals from Venezuela, Latin America and Europe. The family offices' streamlined decision-making process, secrecy and focus on investments with an indefinite time frame give them a significant competitive edge. Other institutional investors and global strategic players are uncommon.

One critical task that must be dealt with from the outset of the transaction is to conduct a thorough due diligence on the potential acquirer to confirm that it is not under any international or US sanctions, or otherwise raises reputational issues.[18]

Financial debt

Financial debt generally does not pose challenges for closing because external financing operations have rarely occurred in recent years. Venezuelan operations have been largely financed by their shareholders merely to stay afloat. In these transactions, inter-company debt is generally capitalised before the sale or is transferred to the buyer. And as mentioned above, local currency financing became diluted by hyperinflation.

'As is' transfer

Transfers are typically made on an 'as is' basis, with very limited sellers' representations and warranties and indemnity obligations. Sellers' representations and warranties are generally limited to 'fundamental representations', that is, representations and warranties relating to organisation and standing, capitalisation, powers and authority, consents and approvals and title, and representations and warranties related to anti-money laundering (AML), anti-corruption, and trade sanctions. Sellers typically require that buyers provide representations and warranties related to organisation and standing, powers and authority, consents and approvals, sources of funds, no financing condition, AML, anti-corruption and trade sanctions, as well as nonreliance provisions. R&W insurance is not currently feasible given local conditions, and political and economic risk insurance is not available.

Asset purchase versus stock purchase

Sales are generally structured as stock transactions. Asset deals are very uncommon, as they are very complex to structure and in most cases trigger regulatory approvals that are not required in stock transactions; for example, in an asset deal, environmental, sanitary, industrial and other permits must be amended or reissued by regulatory authorities, which may significantly delay the closing of the transaction. Asset deals may also raise significant tax liabilities. In addition, asset deals may have to comply with local bulk transfer requirements to protect purchasers from pre-closing non-transferred liabilities of the target's business, and compliance with such bulk transfer requirements does not properly isolate purchasers from labour and tax liabilities of the target's business. Under local law, purchasers are jointly and severally liable with the seller for the tax liabilities of the target's business for a certain period following the notice of transfer to the tax authorities.

18 id.

Purchase price and valuation methods

Purchase prices are distressed mainly because of the country's uncertain near-term future. The price is generally paid at closing in US dollars or other foreign currency in bank accounts located outside Venezuela, as there are no local foreign currency exchange or other restrictions to do so. Prices are generally not subject to adjustment for working capital, net financial debt or other pre- or post-closing adjustments. Selling at distressed prices sometimes results in accounting losses to the selling shareholders. In certain cases, the price has been nominal, as sellers' elimination of their country risk, operating expenses and ongoing liabilities may be sufficient consideration.

Valuation methodologies used in distressed M&A transactions taking place in other jurisdictions (such as adjusted DCF valuation, comparable company analysis, precedent transactions, etc.) are seldom used in Venezuela given the extreme difficulty in forecasting future cashflows in hyperinflationary economy fraught with political risk, and given the limited amount of publicly available transaction data. In many cases, sellers quantify the operating expenses and ongoing liabilities they will have to continue to incur if they don't sell the business, and buyers estimate how fast they will get the purchase price back and how the company would be valued in a normalised economy. Buyers will often look at the investment as a call option on a Venezuelan political or economic change and recovery that would lead to significant valuation re-rating. In these cases, an analysis of the company's staying power, market position, and ability to generate cash under all macro conditions is key.

Investment bankers

In some cases sellers engage the services of investment bankers (commonly local boutiques or regional players) to assist them in the selection of potential buyers, negotiation of price and other financial terms and due diligence process. Purchasers seldom engage investment bankers. Many transactions do not involve investment bankers at all.

Local management

Given the scarcity of skilled local talent, distressed M&A transactions often include agreements to retain the top management of the Venezuelan business being sold.

Simultaneous signing and closing

Except for transactions involving companies operating in regulated sectors (such as insurance, banking and telecom), signing and closing take place simultaneously. Unlike most of the other countries of the region, antitrust filings are not mandatory in non-regulated sectors in Venezuela. When signing and closing are simultaneous, sellers run the expropriation risk until the transaction is consummated. If signing and closing are not simultaneous (for regulatory or other reasons), then purchasers typically negotiate the inclusion of no expropriatory acts as a closing condition and the occurrence of expropriatory acts as cause for termination of the transaction.

Covenants

As signing and closing usually take place simultaneously, pre-closing covenants (such as conduct of business) are usually not included. In certain transactions, purchasers have accepted post-closing covenants relating to continuation of the business and treatment of employees. However, in general, purchasers are reluctant to accept such covenants. In any event, as mentioned above, under current conditions it is very difficult for purchasers to discontinue the business, break up the company for its assets, or unilaterally terminate employees.

Repurchase options

In certain transactions, sellers negotiate an option to repurchase the Venezuelan business at a significant premium. This option allows sellers to re-enter the Venezuelan marketplace if the political or economic conditions improve. Given the significant uncertainties on the political and economic prospects of the country, it is generally very difficult to agree on a valuation method to calculate the repurchase price.

Governing law and dispute resolution

There are no restrictions under Venezuelan law for the sale of the equity interests of a Venezuelan company to be governed by foreign law. Distressed M&A transactions are governed by Venezuelan law, New York law or the law of the jurisdiction of one of the parties.

The parties to the distressed M&A transactions generally agree to subject their contractual disputes to arbitration seated in cities outside Venezuela (Miami is a fairly common choice). Venezuela is a party to the 1958 New York Convention.

Post-closing challenges

As mentioned before, sellers generally provide limited representations and warranties and related indemnity obligations, buyers are willing to agree on very few covenants, and purchase price adjustments are uncommon. Therefore, sellers' and buyers' contractual liabilities are limited and so are post-closing challenges, as buyers assume the risk of several post-closing challenges that are inherent to a distressed business. The few disputes arising from the transactions tend to be solved through negotiation rather than arbitration or litigation.

Conclusion

The fact that M&A activity continues in Venezuela despite one of the longest and most devastating crises in modern history suggests some cause for optimism in that there are those willing to bet on the country's future. Only time will tell if such investors are wildly successful contrarians. Investors in other Latin American economies should be heartened that dogged determination will enable them to close deals even in the most trying circumstances.

9

Deal-Related Litigation in Latin America

Carolina Posada, Jaime Cubillos and Estefanía Ponce[1]

M&A deal flow in Latin American jurisdictions has not been as prominent as in other jurisdictions, including the United States. For example, for the first three quarters of 2020, according to KPMG,[2] approximately 8,391 M&A transactions were announced or consummated in the United States, while, according to Transaction Track Record,[3] 1,517 M&A transactions were announced or consummated in Latin America, and the aggregate value of those transactions was US$1,136.5 billion and US$46.8 billion, respectively. It is not surprising, then, that there is also less deal-related litigation in Latin America than in the United States. However, even on a proportional basis, there also appears to be less deal-related litigation in Latin America than in the United States and other common law jurisdictions, where the system itself favours the development of corporate law through judicial precedent. For example, according to Cornerstone Research,[4] between 2009 and 2018 an average 86.5 per cent of M&A deals over US$100 million resulting from acquisitions of publicly traded companies in the United States were challenged by M&A related litigation from shareholders claims (that is, excluding all private target deals, disputes between buyers and sellers and representations and warranty insurance claims). This type of litigation is almost non-existent in Latin America, given the size of the capital markets and the minimal number of M&A transactions in our jurisdictions that occurred over publicly traded targets.[5]

1 Carolina Posada and Jaime Cubillos are partners, and Estefanía Ponce is an associate at Posse Herrera Ruiz.

2 Pitchbook – KPMG, 'North American M&A Report Q3 2020', 2020

3 Transaction Track Record, 'Latin America Quarterly Report – 3Q 2020', 2020.

4 Cornerstone Research, 'Shareholder Litigation Involving Acquisition of Public Companies – Review of 2018 M&A Litigation', 2019.

5 See Chapter 7 of this guide.

This article covers disputes between buyers and sellers and other signatories to the M&A agreements, as opposed to derivative claims by shareholders of the target or of the seller or acquirer and other third party claims. There is a common view across Latin America that our jurisdictions are not as litigious as the United States or Europe when it comes to M&A deals. This is our perception and experience in Colombia, and it seems to be aligned with that of our colleagues across countries in Latin America.

Colombia is in fact highly litigious across the board, on torts, criminal matters, general civil and commercial litigation, administrative and government contracting matters, real property, family and estate matters, corporate governance issues, etc. This is one of the reasons why our court system is so heavily congested, and even though lawsuits and criminal investigations are common and numerous, final decisions take years or even decades to obtain.

However, the litigious nature of the Colombian market has not historically permeated the M&A deal-making arena. As a result, decisions in the court system related to M&A deals are extremely limited, and while there has been some activity in recent years in arbitration, there is only a handful of publicly available arbitration awards that have been produced regarding M&A matters. Most of those arbitration awards are fairly recent and started emerging back in the early 2000s.

We believe that deal-related disputes in Colombia have been on the rise. Some years ago, the norm seemed to be that parties would shy away from initiating claims, whereas in recent times, we have seen that parties will increasingly consider initiating post-closing, deal-related claims, whenever they have a contractual right to do so.

When speaking with our colleagues throughout Latin America, we have seen that our experience in Colombia is similar to what they seem to be facing in their home jurisdictions. This article will assess the perception of experienced M&A practitioners on deal-related litigation in Latin America. For that purpose, we have conducted a survey of 18 M&A practitioners from LatinLawyer 250 firms, with substantial experience under their belts.[6]

The result is not surprising, the general perception across Latin American jurisdictions is that deal-related litigation may be on the rise in recent years.

Hard data is not available at this point and therefore in this article we offer comments and thoughts on the trends in the region based on the results of such survey.

Participants in the survey generally perceive that pre-litigious claims have moderately increased, and that deal-related litigation has maintained or moderately increased.

Practitioners were asked about their perception regarding the status of pre-litigious deal-related claims (excluding lawsuits), as well as to actual disputes initiated (whether in the ordinary court systems or in arbitration) in their jurisdictions. They were requested to classify whether such pre-litigious claims, on the one side, and actual proceedings in litigation or arbitration, on the other side, over the past five years, had reduced significantly, reduced moderately, remained consistent, increased moderately or increased significantly.

6 We delivered a Q&A form to some of the most important law firms in Latin America. 18 respondents participated on an anonymous non-attribution basis and provided their responses between 28 August 2020 and 10 September 2020.

The results were as follows:

	Reduced significantly	Reduced moderately	Remained consistent	Increased moderately	Increased significantly
Pre-litigious Claims	0 per cent	7 per cent	27 per cent	60 per cent	6 per cent
Lawsuits	0 per cent	7 per cent	40 per cent	47 per cent	6 per cent

Our results indicate that there is a trend of a moderate increase in deal-related, pre-litigious claims over the recent years. The numbers of actual lawsuits, on the other hand, have in general remained consistent with a slight trend of moderate increase in the region.

It appears that the trend throughout the region matches what we believe has been occurring in Colombia, where pre-litigious, deal-related claims, are increasing. Parties in M&A deals seem to be more determined to initiate claims to enforce rights available in their agreements. However, the trend of an increase in lawsuits on deal-related matters is not as evident. It may be that parties are more wary to begin full-blown litigation or arbitration, whereas they are becoming more and more comfortable with initiating claims to at least prompt a negotiation with opposing parties to resolve differences. It may also be the case that most claims may be settled prior to reaching the courts or arbitration panels.

Practitioners generally perceive that a majority of deal-related claims are resolved by direct negotiations of the parties.

Practitioners were asked about their perception as to how M&A-related disputes are commonly resolved, whether through direct negotiations, with the assistance of a third-party mediator, or through litigation or arbitration proceedings. We tallied and grouped the results and came up with the following categories for our results:

Percentage of disputes practitioners perceive are resolved in the categories to the right	Disputes are resolved by direct negotiations or with assistance of mediators or other forms of ADR	Disputes resolved by litigation or arbitration
0–50 per cent	20 per cent	100 per cent
50 per cent–75 per cent	20 per cent	0 per cent
75 per cent–100 per cent	60 per cent	0 per cent

This survey shows that a significant majority of disputes are resolved by avoiding litigation or arbitration. In effect, 60 per cent of respondents believe that 75 per cent to 100 per cent of disputes are resolved by direct negotiation (or with the assistance of mediators), whereas all respondents believe that less than 50 per cent of disputes are resolved by arbitration or litigation. It would seem that parties in Latin America consistently seek to resolve M&A-related matters outside of courts or arbitration tribunals.

Practitioners generally perceive that parties overwhelmingly prefer to submit dispute resolution to arbitration (be it local or international) over the court system of their respective jurisdictions.

Practitioners were questioned as to their experience with respect to the selection of dispute resolution mechanisms in M&A agreements, asking them to indicate which of the following mechanisms were more commonly used in their agreements: court system, local or international arbitration. We also included a third slot for other mechanisms, such as mediation, *amigable composición*, or others. We tallied and grouped the results, as follows:

	Agreements selecting courts as dispute resolution mechanism	Agreements selecting international or local arbitration as dispute resolution mechanism
0–50 per cent	94 per cent	6 per cent
50 per cent–75 per cent	6 per cent	14 per cent
75 per cent–100 per cent	0 per cent	80 per cent

More than 90 per cent of respondents considered that fewer than half of dispute resolution clauses in M&A agreements included a submission to jurisdiction of courts, whereas 80 per cent of respondents considered that most (75 per cent to 100 per cent) dispute resolution clauses in M&A agreements provided for arbitration.

Based on these results, it seems that arbitration as a dispute resolution mechanism is highly popular as compared with domestic courts or other dispute resolution mechanisms. We could not identify a market preference for international or domestic arbitration as responses were generally divided, with some jurisdictions slanted towards domestic arbitration and others towards international arbitration.

Issues that are more commonly disputed include purchase price adjustments, indemnification obligations and issues regarding escrow arrangements and amounts that may be retained.

We asked our colleagues which topics or issues are commonly the object of disputes in the M&A context in their respective jurisdictions. We coined general broad topics to facilitate the response, including disputes regarding the satisfaction of conditions precedent, material adverse change clauses, purchase price adjustment mechanisms, indemnification obligations, limitations to liability, process for claims, sand-bagging related matters, among others. We also asked our colleagues to indicate whether the litigation or disputes regarding the following topics or issues is common or uncommon. The results were as follows:

Topic/issue	Percentage of respondents who consider the disputes around this topic/issue are common	Percentage of respondents who consider the disputes around this topic/issue are uncommon
Satisfaction of conditions to closing	25 per cent	75 per cent
Material adverse change	33 per cent	66 per cent
Compliance of interim covenants	19 per cent	81 per cent
Purchase price adjustment	94 per cent	6 per cent
Indemnification obligations	94 per cent	6 per cent
Application of limitations of liability	44 per cent	56 per cent
Fraud, wilful misconduct, bad faith and similar actions	13 per cent	87 per cent
Procedural aspects regarding claims	50 per cent	50 per cent

Topic/issue	Percentage of respondents who consider the disputes around this topic/issue are common	Percentage of respondents who consider the disputes around this topic/issue are uncommon
Valuation of damages claimed and right to retain amounts under escrow arrangements	75 per cent	25 per cent
Sand-bagging related claims; whether an issue was disclosed by seller or should have been known by buyer	53 per cent	47 per cent

Based on these responses, certain topics appear to be commonly litigated or disputed, such as post-closing indemnification and purchase price adjustment. Additionally, we can also see that claims regarding pre-closing matters, such as conditions precedent, the occurrence of a material adverse change, are not as common.

Timing considerations regarding deal-related litigation

Colleagues were asked to opine on the timing required to resolve claims in their jurisdictions. On the one side, they were asked how long does it usually take for a claim to evolve into litigation or arbitration, or otherwise to be resolved by direct negotiation. Further, we asked our colleagues about their perception regarding the duration of proceedings in arbitration and in the ordinary court system in their respective jurisdictions. The responses were tallied to show the percentage of respondents for each option. The results were the following:

	Less than 12 months	Between 12 and 24 months	Longer than 24 months
Average duration of a claim until it evolves into a proceeding or is settled out of court or arbitration	62 per cent	38 per cent	0 per cent
Average duration of arbitration	25 per cent	75 per cent	0 per cent
Average duration of proceeding before ordinary courts (first instance decision)	0 per cent	25 per cent	75 per cent

A majority of our respondents believe that claims will either get resolved or evolve into a court or arbitral proceeding in a fairly short period of time (less than 12 months). Once a lawsuit has been initiated, arbitration seems to be the mechanism that will deliver a decision on a shorter period of time.

Our conclusions and analysis on the results of our survey

Deal-related claims and litigation may be on the rise in Latin America, but parties seem hesitant to engage in full-blown litigation or arbitration.

Pre-litigious, deal-related claims seem to be on the rise in the region. This trend is not as overwhelming for full-blown litigation or arbitration proceedings. However, there is still an increasing trend in deal-related lawsuits. In effect, 66 per cent of our respondents across the region believe that pre-litigious claims have increased over recent years, whereas 53 per cent of our respondents believe that deal-related lawsuits have also increased.

The survey would support the conclusion that parties in M&A deals are more comfortable initiating formal claims to seek to enforce their rights, but still not as convinced to go through with a full-blown litigation or arbitration to resolve disputes. This may also suggest that most claims are resolved prior to reaching the courts or arbitration by mutually satisfactory settlements. Accordingly, our survey showed that disputes in the M&A arena are resolved by negotiations of the parties, with 60 per cent of respondents indicating that more than 75 per cent of deal-related claims are resolved by direct negotiations (or with the assistance of a mediator), whereas 100 per cent of respondents indicated that less than 50 per cent of claims are resolved through litigation or arbitration. Parties seem to avoid a formal proceeding before courts or arbitrators.

This initial conclusion can have several explanations:

- Based on our experience, parties may be inclined to avoid full-blown litigation for several reasons: cost, time and effort are most likely the main reason for parties to avoid full-blown litigation or arbitration. Regarding time, the results of our survey show that 75 per cent of respondents believed that reaching a final decision in arbitration may take between 12 to 24 months, whereas 75 per cent of respondents believed that a resolution in ordinary courts may take more than 24 months.
- Clients are always hesitant to initiate litigation or arbitration unless there is a positive cost-benefit expectation. However, even though less common, there are cases where clients decide to initiate full litigation or arbitration as a matter of principle to defend their organisation's interests and reputation in the market, regardless of the potential costs and benefits. Some clients also may go into court or arbitration proceedings with the expectation that a settlement early on may be available, often believing that initiating a lawsuit is a necessary step to bring the counterparty into settlement territory.
- In some cases, parties may avoid litigation over a certain topic, as it may produce the effect of triggering the other party's determination to also pursue full-blown litigation over other claims that could have not evolved into lawsuits or could have been resolved otherwise by negotiations. Once the door to litigation is open, when engaged and focused on litigation, and knowing that legal fees and other costs will begin to accrue, parties will usually decide to go ahead and claim for all other matters pending to be resolved. Therefore, parties may be hesitant to trigger the domino effect that could result from initiating litigation.
- Escrow agreements may have a significant impact on post-closing, deal-related litigation. Our survey did not address questions regarding the effect of escrow arrangements in litigious settings, and the ability of claiming parties to retain portions of an escrow as a result of valid claims. It is unclear whether parties are more swayed to initiate claims when there is an escrow in place, allowing for retention of cash amounts in the escrow as a result of such claims. As we see it, the buyer's opportunity to retain cash in an escrow arrangement has the potential to change the mindset of both parties when deciding whether to initiate claims.
- Absent an escrow (or similar guarantee)[7] the defendant to such claim will have no immediate economic incentive to dedicate substantial time and efforts to amicably

7 See Chapter 14 of this guide regarding escrows and other indemnity guarantees.

resolve claims, unless such claims have a strong basis or have the ability to cause increased damages.

In our view, a lack of escrows or similar guarantees in an M&A deal disincentivise parties to pursue claims or initiate lawsuits, such as M&A deals that include liability-restricting provisions (such as caps, baskets and de minimis).

Parties prefer to submit to arbitration rather than the domestic ordinary court system

Arbitration seems to be the prevalent choice as a dispute resolution mechanism in M&A deals in Latin America. Arbitration, whether domestic or international, appears much more popular than litigation in the domestic courts. The results across Latin America match what we are seeing in deals in Colombia where the discussion in negotiations mainly revolves around whether the choice would be domestic arbitration or international arbitration if available, and domestic courts are hardly ever considered.

Parties' preference towards arbitration could be related to the estimated period of time that it takes for each proceeding to come to a conclusion. Whereas in arbitration, 100 per cent of respondents believe that, on average, an arbitral proceeding takes less than 24 months to reach a conclusion, when it comes to the ordinary court system, 75 per cent of respondents believe that a proceeding in average will take more than 24 months to reach a first instance decision (which could be subject to appeal, and therefore a final decision in a second instance will take a longer period of time to be reached).

Additionally, as discussed in point one above, at least in Colombia, practitioners may have the perception that, while in arbitration, the parties will have the ability to appoint arbitrators who have experience and have had exposure to M&A transactions or to issues related to M&A matters and contracts law, there is significant uncertainty in the ordinary court system and its unclear whether the appointed judge has comparable experience to that of hand-picked professional arbitrators. Local courts may also be ill-equipped to appropriately handle M&A disputes compared with international arbitrators with respect to cross-border M&A transactions in which the deal documents are frequently drafted in English or governed by an internationally recognised foreign substantive law with comprehensive case law on M&A matters (such as New York law).

Most common matters over which claims or disputes revolve around are purchase price adjustments and post-closing indemnification matters. Litigation over pre-closing matters is generally uncommon.

Several observations can be made based on the responses regarding the topics or issues that are commonly or uncommonly disputed:

- Topics and issues that are more commonly disputed revolve around post-closing matters, such as purchase price adjustment and indemnification obligations, where, in both cases, 94 per cent of practitioners believe such topics are commonly disputed.
- Topics that address pre-closing issues, such as the satisfaction of conditions precedent and the occurrence of a material adverse change, are not as commonly disputed (where 75 per cent of respondents, for the case of conditions precedent, and 66 per cent

of respondents, for the case of material adverse change, consider such topics not to be commonly disputed).

Based on these responses, we could infer that, in Latin America, pre-closing issues, such as the satisfaction of conditions to closing or the occurrence of a material adverse change, which generally revolve around closing certainty, are not as common.

This survey was distributed to respondents four months into the covid-19 pandemic. Pre-closing issues were still being analysed and it would be premature to discuss definitive conclusions applicable throughout the region. In Colombia, we have seen several ongoing transactions that have debated the occurrence of a material adverse change, but we are still to see lawsuits initiated seeking performance or damages.[8]

Based on responses, it seems that parties are mostly focused on claiming issues with direct monetary implications, such as purchase price adjustments and post-closing indemnification provisions. The general perception of respondents is generally aligned with ours in Colombia. We believe that, in Colombia, most of the issues that rise to a level of a claim or lawsuit revolve around provisions regarding adjustments to the purchase price and post-closing indemnification obligations where the calculation and payment of monetary damages is critical, and less on specific performance with injunctive relief.

We believe that responses regarding claims and lawsuits on purchase price adjustment provisions deserve special attention from practitioners. While some may think that purchase price adjustments should be merely an update of uncontroversial figures, there are many details on the way in which accounts are developed and reflected, and variations in methodology that may cause disputes. Consistently, respondents perceive in an overwhelming majority that disputes relating to purchase price adjustment are common in their jurisdictions.

The result of the survey on this point raises a few questions that we believe should be analysed by practitioners with their clients: are we using the purchase price adjustment provision to renegotiate the purchase price, or as a backdoor avenue to bring claims that would otherwise be indemnification claims on the basis of breach or inaccuracy of representations and warranties, which are subject to specific limitations and survival provisions? Does this mean that the parties are not fully aligned on their agreement on the purchase price, which is absolutely critical? Therefore, it may be a question on whether parties are silently delaying a discussion on purchase price.

Alternatively, maybe the parties are just not really aligned on how the purchase price adjustment provision will be applied after closing. If this is the case, practitioners should be focusing more during negotiations to ensure that both parties and their financial and accounting teams understand and fully appreciate the implications on how the purchase price adjustment provision will be applied.

The responses on the frequency of post-closing indemnification matters do not come as a surprise. This implies that parties negotiated post-closing indemnification rights and find, after closing, that the target may suffer losses that are indemnifiable under the

8 See Chapter 1 for further analysis of the impact of the covid-19 pandemic on M&A in the region.

contract. In fact, these provisions are allocations of risk that need to be honoured when the risk materialises, and often the disputes revolve around the scope of the assumed risk and the qualification and assumption of the identifiable losses.

It is interesting to see that parties are divided in their responses as to whether issues relating to 'sand-bagging' (whether the buyer knew or should have known and whether such knowledge or constructive knowledge should preclude the buyer from benefiting from indemnification rights). Thus, 53 per cent of respondents believe that discussions regarding 'sand-bagging' matters are common.

In Colombia, we believe that even though this discussion is rather common, it is not necessarily the focus of the attention in a claim. This may be because the whole discussion on 'sand-bagging' issues opens up a much broader question on whether the parties, buyer and seller, have been acting in good faith or have been diligent throughout the negotiation and after closing. It is certainly a hot topic that, if elicited by a court, has the potential of questioning indemnification rights that parties may have thought were uncontroverted under the contract.

Finally, practitioners generally believe that disputes relating to escrows and the amounts that may be retained are also common (with 75 per cent of practitioners indicating such disputes are common in their jurisdiction). This response is also consistent with what we are seeing in Colombia. The question on whether retention of cash during the pendency of a final resolution of a claim is available under the escrow, and how claims are valued, are the aspects of escrow agreements that are more frequently debated.

We believe that deal-related litigation in Latin America will continue to evolve, in numbers and in substance, which underscores the critical role of M&A practitioners in constantly improving practices, procedures and forms to ensure that agreements are well-equipped to reduce disputes with abundantly clear language that can withstand future litigation or arbitration.

Part IV

Select Topics Critical to Deal-Making

10

Acquisition Finance in Latin America

Denise Grant, Augusto Ruiloba, Lisseth Rincon and Rita Ghanem[1]

When considering the structuring of an acquisition, one of the principal decisions to be made is how to most efficiently finance the purchase. The buyer needs to strike a balance – the financing should be cost-efficient as it affects the cost of the acquisition generally (in a bid scenario, cost-efficient financing may give the buyer a competitive advantage in the purchase price negotiations), while at the same time, it should also be non-restrictive in order to allow the buyer the necessary freedom to manage and expand the acquired business after closing. Although the financing is obtained by the buyer and provided by the debt providers, the seller is also interested in ensuring that the buyer has locked in the financing to be able to pay the purchase price at closing.

In this chapter, we will discuss some of the most common considerations for acquisition financing in Latin America, as well as related trends, practices and challenges, focusing primarily on the six largest economies in Latin America – Argentina, Brazil, Chile, Colombia, Mexico and Peru –from a New York perspective. Section I provides a market overview of acquisition finance in Latin America for 2019 and the first half of 2020, and some of the current trends. Section II examines matters to be considered when structuring an acquisition financing. Sections III and IV outline certain noteworthy provisions typically included in the loan and acquisition documentation. Finally, Section V highlights certain Latin America-specific considerations in debt financing transactions.

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Market overview of acquisition finance in Latin America

Current trends

More than half of the largest M&A transactions (in terms of deal value) in Latin America are typically financed in whole or in part by debt. However, that was not the case for the first half of 2020, which, based on our review of the biggest loan issuances in the market, saw a significant decline in the value of leveraged and non-leveraged loan issuances in the region,[2] most likely due to the volatility and augmented caution from investors and lenders as a result of the covid-19 pandemic.[3] In fact, based on our review of more than 20 publicly available acquisition transactions, less than half of the 20 largest acquisitions in 2020 were partially funded with proceeds from loans or bonds, or both.[4]

Unlike acquisition financing in the US and European markets, which are commonly limited in recourse to the shares of the target and its assets, in Latin America, the financing sources typically have full recourse to the buyer. Often that recourse extends to the balance sheet of the ultimate sponsor, coupled with a parent guarantee. Although some financings in Latin America have been done on a limited recourse basis, they are not as common.

Latin America has also witnessed cutting-edge developments in bank acquisition financing. The green loan provided to Agrosuper, the Chilean food conglomerate, to acquire Empresas AquaChile, a local fish farming company, is a good example. The acquisition qualified for the green loan benefits as it reduced the use of antibiotics in salmon.[5]

Another debt financing structure worth noting is reflected in the financing put in place for the acquisition by Trident Energy and Karoon Energy of certain upstream assets from Petrobras,[6] which took the form of a reserve-based lending. This structure will certainly be considered for future transactions in the most active markets for oil and gas M&A in the region.

Raising capital in the IPO market is another trend that has gained interest in Brazil. While the use of proceeds is generally labelled as general corporate purposes, market participants indicate that more often than not companies are raising funds to effect acquisitions.

Of the six largest economies in Latin America, Argentina is the one that has seen the most significant change in the past year. The increased foreign exchange risk (discussed below), as well as general volatility in Argentina, have made it more complex for buyers to obtain financing from typical sources in the international bank and bond market, and as a result, Argentine transactions have also attracted debt providers and funds that typically

2 This M&A and acquisition financing market analysis is based on independent research that the authors of this chapter undertook based on deals in the market that are publicly announced or included on various databases including S&P Capital IQ and Refinitiv Loan Connector.

3 See Chapter 1 of this guide for further analysis of the impact of the covid-19 pandemic on M&A transactions in Latin America.

4 See footnote 2.

5 See *La Tercera*, 'Agrosuper suscribe crédito verde por US$100 millones para financiar compra de AquaChile', (29 October 2018) found at https://www.latercera.com/pulso/noticia/agrosuper-suscribe-credito-verde-us100-millones-financiar-compra-aquachile/380587/ (last visited 27 September 2020).

6 See *Latin Finance*, 'Brazil ushers reserve-based lending' (16 August 2019) found at https://www.latinfinance.com/daily-briefs/2019/8/16/brazil-ushers-in-reserve-based-lending (last visited 27 September 2020).

have a higher risk appetite, provide more expensive financing and require tighter terms and conditions and a more fulsome collateral package.

Structuring a debt financing for an acquisition

There are three primary factors that affect the structure of debt financing: (1) whether the acquiror is a strategic or financial buyer, (2) whether the M&A transaction is an exclusive direct negotiation or a competitive bid and (3) the financing sources available for the buyer and the target assets or business.

Strategic versus financial buyer

Strategic buyers are looking to expand their ongoing business and, accordingly, will be seeking the least costly financing that will not restrict their ability to operate and expand their business. Accordingly, strategic buyers are more willing to provide lenders recourse to their balance sheet to obtain more favourable financing terms. Thus, debt financing provided to strategic buyers is typically structured as unsecured short-term or bridge loans with full recourse to such buyers' balance sheet. This arrangement is usually followed (under normal conditions, long in advance of the maturity date of such loans) by a capital markets transaction (or permanent term loan) to repay the loans and raise additional capital for the target's operations, also referred to as a 'bridge to bond'.

When the buyer is a private equity fund or other financial sponsor, such buyer is interested in adding value by repackaging the acquired business and exiting in a relatively short time frame (see Chapter 3 of this guide). The acquisition debt will typically be structured as a loan provided to a special purpose entity created solely for the purpose of acquiring the target, and such loan will be secured by all the assets of the borrower (e.g., the shares of the target in a stock purchase), when permitted. To avoid structural subordination issues caused by the fact that the target's lenders will structurally be senior to the buyer's lenders with respect to the target's assets, either a merger between buyer and target will follow or the acquisition financing will refinance any existing debt of the target. This financing arrangement for a financial buyer may also be structured as a bridge to bond.

Private sale versus competitive bid

In an auction process, the sellers invite several bidders to compete to acquire the target. One of the key elements that a seller will consider when analysing bids is whether the buyer will finance the acquisition with debt and, if so, what is the risk that such financing will not be available at the time of the closing of the acquisition. To address this risk, the auction draft acquisition agreement and the definitive agreement will typically not include a 'financing out' provision, which would otherwise allow a buyer to walk away from the deal if it is unable to obtain financing. Another way sellers mitigate the risk is scrutinising the conditions to the disbursement of the loans and favouring bids with limited conditions. As a result, commitment papers negotiated between buyers and their debt providers in a bidding process will often include 'SunGard' provisions (examined in more detail below), which limit the conditions to be satisfied for funding the debt.

In a private sale, where the M&A deal terms are bilaterally negotiated between buyer and seller, the buyer will be in a better position to negotiate more favourable provisions with respect to the availability of financing in the acquisition agreement and, thus, debt financing in those cases may often resemble financing provided in a non-acquisition context.

Financing sources

In an environment of historically low debt rates, buyers around the world have sought to finance their acquisitions, in whole or in part, with debt. Prior to the covid-19 pandemic, acquisitions in Latin America have been no exception and buyers have flocked to the bank debt market. The most common financing structure in Latin America is the bridge to permanent financing, be it a bond or term loan. Based on our review of the top 20 deals (by deal value) that closed in 2019, at least 25 per cent of financed acquisitions consummated by strategic buyers involved a combination of loan and bond financing, approximately 30 per cent relied only on bond issuances and the remaining acquisitions were financed solely with bank debt.[7]

Unlike the US market where buyers will often finance an acquisition in the capital markets (and thus bridge facility commitment papers are only entered into as a back-up), bridge loans in Latin America are usually funded. The preference to fund bridge loans instead of directly financing an acquisition through the bond market is due, among other things, to the limited access to capital markets for some buyers and smaller and less liquid markets generally in the region, which may constrain a buyer's ability to timely complete a bond offering. Additionally, stricter confidentiality obligations and unavailability of certain information delay the buyer's efforts to satisfy disclosure obligations and its ability to immediately go to the bond market prior to the closing of the acquisition. Finally, funding the acquisition through bridge financing also enhances the certainty of funds on the date of closing the acquisition, ensuring that buyers will have the funds to pay the purchase price. Furthermore, commercial bank debt provides flexibility when there are tight time constraints and sometimes unexpected developments. Buyers also prefer the agility of a bridge loan where they can decide after the acquisition, when the negotiating leverage has shifted, whether to take out the bridge loan with a term loan or bond.

Another form of acquisition financing vehicle that has recently resurged in the market, particularly in the United States, are SPACs – special purpose acquisition companies. A SPAC is a company sponsored by an investor and management team with experience and reputation for identifying, acquiring and operating businesses that raises capital through an IPO to pool funds for the purpose of effecting acquisitions of targets yet to be identified in a set period of time. SPACs are now ubiquitous in the US market, raising over $12 billion during the first half of 2020.[8] Similar structures, although few, have been used in Latin America

7 See footnote 2.

8 See https://inspirgroup.com/en/spacs-an-attractive-alternative-to-an-ipo-for-target-companies/ (last visited 27 September 2020). The same article mentions that there are around 71 SPACs on the market currently that are seeking targets, five of which are seeking acquisitions in Latin America.

as evidenced by the successful US$650 million IPO by Vista Oil & Gas, SAB de CV (Vista) in 2017 in Mexico.[9]

Based on conversations with leading fund managers in Latin America, the view is that more activity in SPAC transactions is foreseen due to investors' appetites for IPOs and the availability of assets in post-covid recovery. Despite this enthusiasm for the future of SPACs in the region, consummating a SPAC transaction in Latin America is not without challenges, particularly as countries in the region do not currently regulate this type of structure. SPACs more typically appeal to foreign investors and are denominated in US dollars, and accordingly, will likely only be available for industries in which revenue is generated in US dollars; otherwise, they would be vulnerable to currency risks. Additionally, any debt raised by these types of entities would be of a non-recourse nature, which is not as readily available for Latin American borrowers.

Acquisition finance documentation

Like any debt financing arrangement, acquisition finance transactions involve two principal phases. First, the mandate or commitment stage, where buyers and debt providers negotiate the fundamental commercial and legal elements of the facility to be provided, which usually culminates in the signing of mandate or commitment letters documenting the agreed terms. Second, the negotiation of the definitive documentation and closing of the transaction. In acquisition finance, the more important of these phases may indeed be the former, particularly in a competitive bid acquisition where the commitment letters will often be submitted with the bid. These commitment papers generally have the following characteristics: (1) certainty of commitment, (2) market standard 'SunGard' provisions for certainty of funds and (3) market 'flex' provisions.

Level of commitment

As mentioned above, 'financing out' provisions are becoming less common in acquisition agreements and, accordingly, buyers are mitigating that risk by requesting a firm commitment or full underwriting by the bank engaged to arrange the credit facility. Banks will typically accept this risk if they are comfortable that they will not have to hold the loan for an extended period and will be able to successfully syndicate or sell down their commitments. To support a bank's ability to sell down, commitment papers typically include syndication provisions pursuant to which the prospective buyer agrees to assist, and to cause the seller or target to assist, the arrangers to syndicate their loans.[10] Note that the buyer will always

9 See https://latinlawyer.com/article/1145739/vista-makes-landmark-ususd650-million-ipo-in-mexico; See also https://www.shearman.com/news-and-events/news/2017/08/vista-oil.

10 These provisions include making the officers of the buyer or the target available for discussions with prospective debt providers, agreeing to prepare an information memorandum to be distributed to potential lenders or obtaining a credit rating. Further, commitment papers also include, either as a condition to funding or covenant (which is the preferred approach for acquisition finance transactions that include SunGard type provisions) a 'clear market' provision, pursuant to which the buyer or its parent agrees not to syndicate, offer or issue debt during the syndication period. Finally, the assignment provisions of the credit agreement may also reflect the need for syndication by allowing the lenders to assign without the borrower's consent during the syndication period or until an agreed minimum hold

require the arrangers to provide the financing regardless of whether the syndication is successful. Typically, these syndication provisions apply until the earlier of a sunset date or the date the arrangers achieve their desired hold.

SunGard provisions[11]

To mitigate the risk of financing not being available at closing to pay the purchase price, sellers and buyers may require that the commitment papers include limited conditionality to funding, commonly known as, the '*SunGard* provisions'.[12] Essentially, there would be no daylight between the conditions for closing in the acquisition agreement and those for funding under the financing documentation – if the conditions in the M&A documentation are satisfied and the buyer is required to close, the conditions of the financing would also be satisfied and the lenders would be required to fund. SunGard provisions are only used in limited transactions in Latin America, even though there is a trend towards limited conditionality in commitment papers (particularly for buyers acquiring assets in the US or Europe and obtaining financing from commercial banks that are familiar with these provisions).

The *SunGard* provisions typically limit the conditions precedent to funding to the following:

Representations and warranties

Only the most fundamental representations and warranties (commonly referred to as 'specified representations') made under the financing documents need to be true and correct as a condition to funding. The specified representations are typically limited to those with respect to corporate existence, authority, enforceability of debt documents, margin regulations, no conflict, use of proceeds, US Investment Company Act status, solvency, compliance with anti-money laundering and anticorruption laws and creation and perfection of closing date security interests in any collateral.

Limiting the number of representations that are conditions precedent does not mean that the other representations under the financing documents are not made at closing. Rather, if any other representation is not accurate on the closing or funding date, while debt providers will still be required to fund, an event of default would be deemed to have occurred on such date (often referred to as a 'day two default'), giving the debt providers the right to exercise remedies immediately, but only after funding.

is reached (other than to competitors of the borrower and others identified by the borrower, usually referred to as 'disqualified lenders').

11 *SunGard* is the standard used in the US and many large Latin American acquisition financings. The 'certain funds' standard, a variation on *SunGard*, is commonly used in Europe and has made its way to a few Latin American acquisition finance transactions. Under a 'certain funds' approach, the conditions to funding are generally more limited and typically relate to the bidder group only and not to the target and its subsidiaries. For further information, please see https://www.shearman.com/-/media/Files/NewsInsights/Publications/2017/02/Recent-Trends-In-Limited-FN020317.pdf.

12 The *SunGard* provisions are named after the 2005 acquisition of SunGard Data Systems by a consortium of private equity firms, the first public transaction to contain the same.

One common feature of acquisition financing commitment papers is a condition precedent for the closing and funding that the representations made by the seller under the acquisition agreement be true and correct. This condition is also included in commitment papers subject to *SunGard* provisions, albeit modified so that only the representations made by the seller under the acquisition agreement that are material to the interests of the debt providers and that give the buyer the right to terminate the acquisition agreement or to walk away from the transaction need to be accurate, subject to negotiated qualifications in the purchase agreement. How the inaccuracy of the other seller representations under the acquisition agreement is treated under the financing documentation varies depending on, among others things, how the relevant acquisition agreement is structured, and can range from treating the misrepresentation as an event of default (i.e., a 'day two default') to, if such misrepresentation affects the price of the asset and results in a purchase price adjustment, being addressed in the financing documentation by the provisions dealing with purchase price reductions.

Due diligence

The condition commonly regarding satisfactory completion of due diligence or the 'diligence out' is not normally included in commitment papers that include SunGard provisions and debt providers are required to conduct and finalise their due diligence prior to the execution of the commitment letter. We note, however, that it is common for the 'due diligence' condition to be bracketed in the draft commitment papers with a footnote that it is the intention of the parties to remove prior to execution of the commitment papers.

Business MAC

The material adverse change (MAC) definition under *SunGard* provisions will be a mirror of the MAC definition in the acquisition agreement, and the related provisions are triggered solely by any MAC affecting the target. Consequently, one critical aspect of the lenders' due diligence of the acquisition will be a focus on reviewing, commenting on and getting comfortable with the MAC definition included in the acquisition agreement.

Market MAC

Market material adverse change provisions, that is, a material adverse change in the loan, capital or syndication markets generally, or both, which are often common in commitment papers depending on the Latin American country, are typically negotiated out of commitment papers for acquisition financings. Instead, flex rights (see below) are intended to mitigate the effects of market disruptions for syndication purposes.

Collateral

In secured financings, one of the conditions to funding is generally that the security interests in all the collateral be fully perfected. However, to avoid delays in funding acquisition loans owing to the time-consuming process of perfecting certain types of collateral, the *SunGard* version of this condition only requires perfection with respect to security interests that may be perfected on the date of closing (e.g., security interest that may be perfected by means of filing a Uniform Commercial Code financing statement or delivery of certificated securities representing equity interests in the borrower).

Interestingly, the issue of not having a perfected security interest at the time of funding is one with which local banks and most international debt providers that are active in Latin America will be familiar, and is by no means exclusive to acquisition finance in the region. In most secured lending transactions, funding occurs before security interests over all the collateral are fully perfected. Thus, reflecting SunGard provisions in this respect usually follows what is common practice in the particular jurisdiction (e.g., that the condition to funding is the execution of the security documents and that certain perfection steps, such as filing with the relevant public registries, have been taken, and including a covenant to complete the registration within an agreed time period).

'Flex' provisions

Given the limited conditionality nature of commitment papers, particularly the absence of a market MAC, commitments for acquisition financing may be challenging to sell down in the primary or secondary market. In addition to the syndication cooperation covenants of buyers, debt providers try to protect against adverse market conditions by including 'market flex' provisions in their commitment papers. These provisions allow debt providers (that determine that their syndication efforts based on the proposed financing terms have been or will be unsuccessful) to adjust those terms, usually by increasing the pricing and modifying other terms within parameters agreed with the buyer to make the financing more attractive to the market. Parameters of common flex provisions include: when the flex can be exercised (i.e., usually by pre-determining what would qualify as 'successful syndication' defined by a minimum hold for each bank), the time period within which the flex can be exercised, whether the flex can be exercised with or without consulting the borrower and whether provisions other than pricing can be flexed.

Protections for debt providers in acquisition documentation

One of the important items of due diligence performed by debt providers and their advisers in connection with an acquisition financing is the review of the acquisition agreement. Aside from more obvious reasons like understanding the terms of the acquisition, learning more about, and analysing, the target and its assets through the representations and warranties, there are two additional reasons for debt providers to review the acquisition documents: (1) ensuring the target's cooperation with the financing and (2) limiting the debt provider's exposure to claims under the acquisition agreement.

Cooperation with financing

As discussed earlier, buyers are usually required to assist and to cause the seller and target, both of which have more familiarity with the target and its assets, to assist the debt providers with their diligence and syndication efforts. This obligation is commonly documented in the acquisition agreement through the inclusion of a financing cooperation covenant, pursuant to which sellers or targets agree to use some level of effort to cooperate with the buyer's financing efforts at the request and expense of the buyer to, among other things, assist in the preparation of marketing materials or information memoranda, make senior management available for meetings with the debt providers and their advisers, arrange for payoff letters, and provide information to allow the debt providers to complete their know-your-customer, anti-money laundering and other internal processes.

Xerox provisions

If an acquisition transaction is not consummated, there is a risk that disputes between buyers and sellers may arise and that the sellers may seek to include the debt providers in these disputes for failure to provide the financing. Further, some acquisition agreements include payment of certain break-up or termination fees by the breaching party (which may be interpreted to include the acquisition financing debt providers).[13] To protect against these risks, debt providers typically insist on including 'no recourse' and 'limitation on liability' language in the acquisition agreement, commonly referred to as the *Xerox* provisions.[14]

No recourse against financing sources

Debt providers usually require that acquisition agreements include a broad disclaimer and waiver from the parties to such agreement providing that neither the seller nor the buyer has recourse in contract, tort, equity or otherwise against the debt providers and cannot pursue litigation against the debt providers directly, including as a result of the debt provider's failure to provide the committed debt financing. This provision does not limit the buyer's rights under the commitment papers and, thus, the buyer may claim damages or seek specific performance from the debt providers if the debt provider failed to fund (particularly if the seller has been successful in including in the acquisition agreement a covenant requiring the buyer to pursue litigation in those circumstances).

Limitation on liability

Acquisition agreements may limit the seller's remedies against the buyer or its affiliates if the buyer fails to consummate the acquisition to the payment of a reverse break-up fee, effectively capping the buyer's liability. In such cases, debt providers will typically require this limitation of liability and any other limitations on the buyer's liability to include the debt providers. This, however, does not override the general no recourse to debt provider' provision mentioned above, but rather works to provide an additional layer of protection for debt providers.

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13 While it is out of the scope of this chapter, most New York law governed acquisition agreements in which the buyer is obtaining financing to consummate the transaction include representations and warranties of the buyer regarding the financing commitment and include covenants from the buyer regarding such financing. Acquisition agreements often include a reverse break-up fee, which obliges buyers that fail to consummate the deal because they were unable to obtain financing or for other reasons to pay a pre-determined fee to the seller.

14 The *Xerox* provisions are based on the merger agreement for Xerox's $6.4 billion acquisition of Affiliated Computer Services, one of the early deals to contain these provisions.

Third-party beneficiaries

Most acquisition agreements include a 'no third-party beneficiary' clause, pursuant to which the parties agree that the agreement is intended solely for their benefit and that of their respective successors and that no other person may enforce the provisions of the agreement. Therefore, for debt providers as third parties to be able to attain the full benefit of the *Xerox* provisions and enforce their rights under the acquisition agreement, debt providers are expressly included as third-party beneficiaries of the *Xerox* provisions included in acquisition agreements.

Amendment and waiver of certain provisions

Finally, as the amendment provision of acquisition agreements typically only requires the consent of the parties to such agreement to modify any provision thereunder, debt providers will require that acquisition agreements that include *Xerox* provisions also include a prohibition on modifying any such provisions (and, sometimes, other key provisions of the acquisition agreement) without such debt provider's consent.[15]

Specific considerations in Latin America

For any acquisition finance transaction in Latin America, the parties will need to assess specific local law considerations for structuring, including the types of collateral available and related creation and perfection requirements, any limitations on financial assistance, withholding and stamp tax applicability, tax efficiency and foreign exchange controls. Those considerations will be informed by the underlying acquisition (whether assets or stock), the organisational structure of the target, the security package offered to the debt providers and the recourse or non-recourse nature of the acquisition financing.[16]

Security interests

The general considerations with respect to security interests in Latin America centre around incurrence of additional costs and the time required for registration and perfection that can often not be achieved at funding. As discussed earlier, funding will typically need to occur before security interests in all the collateral are fully perfected, particularly where certain additional steps need to be taken. Accordingly, certain perfection actions will be required to

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15 International debt providers will typically require that the acquisition agreement provides that any disputes involving the debt providers would be governed by New York law and heard by New York courts, which is typically the preferred jurisdiction and governing law for international debt providers in the Latin America market. Relatedly, the acquisition agreement would typically include the waiver of rights to trial by jury in respect of such disputes that is also common in international New York governed financings. This provision could be separate and in addition to the general dispute resolution clause of the acquisition agreement which may be governed by the laws of another state or country or subject to a forum other than New York courts.

16 Owing to the extensive nature of the subject, we will not be addressing the insolvency regimes of any Latin American jurisdiction. However, debt providers should closely analyse how local insolvency and bankruptcy regulations may affect their interests. For example, Colombian law deems ineffective any contractual provision that may frustrate a reorganisation process, including the acceleration of debt, if directed towards undermining the debtor's reorganization; while in Chile, once a debtor is subject to a bankruptcy proceeding, default interest may no longer be charged on defaulted amounts.

be satisfied at funding, while others will be deferred as needed, thus reducing the execution risk associated with delays in registration of a security interest.

Perfection in most Latin American countries requires specific formalities prescribed by applicable law, including that the security interest be documented in a notarised public deed and registered before one or more public registries. These formalities result in additional costs (including stamp taxes) and may cause delays in the perfection of the debt providers' security interest as the registration process is, with some exceptions, lengthy (in some instances taking more than a month).

Another key aspect for debt providers to consider when taking collateral in Latin America is whether private enforcement is available. In many countries in Latin America, including Argentina, a pledge does not grant the secured creditor the right to privately enforce its rights and foreclose on the collateral, but rather requires enforcement through a court proceeding, resulting in time and cost concerns for borrowers and debt providers upon enforcement. For this reason, some Latin American jurisdictions, like Argentina, Brazil, Colombia, Mexico and Peru, allow lenders to take a security interest in the form of a security trust. Under this arrangement, the collateral is conveyed to a trustee that, upon default, will enforce the secured creditor's rights as instructed by such secured party, which may include conducting a private sale of the assets subject to the trust.

Yet another consideration for borrowers and debt providers are regulations limiting a buyer's right to pledge the shares of the target or the ability of the target to provide a guaranty or pledge its assets to secure the obligations of the buyer to the debt providers (commonly known as financial assistance regulations). Although financial assistance regulations are rare in Latin America, there are exceptions, most notably Argentina and Peru.[17] However, most jurisdictions will require compliance with certain corporate governance regulations. Thus, buyers and debt providers should consult local counsel in the applicable jurisdiction to ensure compliance with these regulations and to understand the potential implications of any non-compliance on the validity of any security in the acquired shares or corporate guarantee.

Finally, some countries in Latin America, such as Colombia and Mexico, have limitations on granting upstream guarantees. If upstream guarantees are being provided by certain types of legal entities, the corporate purpose of the guarantor should expressly include its capacity to provide upstream guarantees.

Withholding and stamp taxes

Taxes play an important role when structuring a financing transaction. An acquisition financing involves tax considerations that are typical for any financing, including the applicability of withholding tax, value added tax (VAT) and stamp taxes.

Withholding tax rates in respect of the payment of interest (and, in some jurisdictions, fees) in Latin America vary by jurisdiction, and can be as high as 35 per cent. However, most

17 In Argentina, for example, there is a restriction on the target company's ability to provide a guarantee or provide financial assistance for the acquisition of its own shares. Peruvian law limits the ability of buyers to pledge the shares of the target and the ability of the targets to provide collateral to secure debt incurred to finance the acquisition.

jurisdictions have a preferential tax rate that will apply to certain foreign debt providers (e.g., financial institutions) from certain jurisdictions (e.g., non-tax havens and jurisdictions with which the country has a tax treaty to avoid double taxation) in connection with certain types of transactions and upon certain requirements being met. The applicability of withholding tax and the availability of the mitigants described above may limit the pool of potential debt providers and viable structures in certain jurisdictions.

Finally, in a few jurisdictions, including Argentina, local stamp taxes might be applicable to the execution of any instrument with economic value. This may include the loan agreement, the promissory notes and the security documents.

Foreign exchange controls

Foreign exchange controls can be one of the challenges in structuring an acquisition financing in Latin America. Although Argentina, Brazil, Chile and Colombia have foreign exchange-related regulations, currently only Argentina imposes foreign exchange controls. Mexico and Peru do not have any such regulations. However, as most of the countries in the region have imposed foreign exchange controls at some point, debt providers should make this part of their customary diligence when providing financing in the region.

Argentine foreign exchange control regulations have become tighter in the past months.[18] The Argentine government has indicated that these regulations are inevitable and will remain in force as the government seeks to stabilise the economy.[19] The most recent set of regulations introduced in September 2020 limit a debtor's ability to repay its Dollar-denominated debt in US dollars by limiting a debtor's ability to access the Argentine foreign exchange market to an amount not greater than 40 per cent of the current scheduled principal amount; the remaining 60 per cent to be either refinanced by extending the average life of the debt by at least two years or by converting the debt into pesos through the foreign exchange market.[20]

Brazil requires foreign indebtedness and related payments to be registered with the Brazilian Central Bank to allow the borrower to remit payments of principal and interest abroad. In addition, any amendments of the payment terms of such foreign indebtedness require registration with the Brazilian Central Bank.

In Chile, there are no foreign exchange controls, but borrowers are required to report certain information on foreign indebtedness to the Central Bank of Chile.

Colombia's foreign exchange is regulated by its Central Bank. While there are no foreign exchange controls as such, foreign lenders must obtain a foreign lender registration from the Central Bank and any foreign indebtedness by a Colombian resident must be reported to the Central Bank prior to or simultaneously with the loan disbursement. Moreover, any

18 See the Argentine Central Bank, the Argentine Securities Commission and the Argentine Federal Taxing Authority issued a group of resolutions tightening foreign exchange restrictions in Argentina, specifically: Communications 'A' 7104, 'A' 7105 and 'A' 7106 of the Central Bank, General Resolution No. 856/2020 of the CNV and General Resolution No. 4815/2020 of the AFIP.

19 See https://www.batimes.com.ar/news/economy/strict-foreign-exchange-controls-to-stay-in-place-says-kulfas.phtml (last visited 27 September 2020).

20 See footnote 19.

payment under foreign loans must be channelled either through the so-called 'exchange intermediaries' (mostly local banks, stockbroking companies and foreign exchange companies) or via registered offshore accounts held by Colombian citizens abroad.

Conclusion

Although activity in the acquisition finance market has slowed as buyers navigate the uncertainty of the covid-19 pandemic, we foresee opportunities in Latin America, including in some of the smaller jurisdictions where M&A activity is increasing. We would expect financings for acquisitions to generally continue to be structured as syndicated or club commercial bank loans, rather than stand-alone capital markets transactions. However, depending on a buyer's access to the local or international capital markets, as well as investors' appetite for debt denominated in local currency, and maturities available in a specific market, we could envision an increase in 12- to 18-month bridge loans that will be refinanced in the local, or if of significant size, the international capital markets.

While financing in Latin America seems to be adjusting to accommodate the requirements of a more challenging acquisition market, accounting for country-specific considerations, it will be interesting to see how these transactions evolve and whether alternative financing structures, like SPACs, become more commonly used.

11

Preliminary Legal Documents in M&A Transactions

Pablo Mijares and Patricio Trad[1]

Term sheets, letters of intent and memorandums of understanding

It is very common to use preliminary legal documents in M&A transactions in Latin America, such as term sheets, letters of intents or memorandums of understanding, as they are useful for parties to quickly and inexpensively set out the commercial terms of a transaction.

In most civil law jurisdictions, there is no specific legal framework around term sheets, letters of intent or memorandums of understanding, and from a practical perspective there are virtually no differences between these figures. We will refer to all these types of documents as 'term sheets' for purposes of this article. The unregulated nature of these documents presents challenges that have been addressed by the market participants in different and creative ways.

From a Mexican law perspective (which is not dissimilar to other civil law jurisdictions), one of the above-mentioned challenges is the fact that the law establishes that, for a purchase agreement to be effective, in general terms, the parties need only agree on the good and its price. Subject to certain formalities, and under a simple but formalistic approach, a term sheet executed by the parties could, therefore, be deemed as a valid purchase agreement by a Mexican court. This is often addressed by clearly establishing that the document serves merely as a preliminary understanding of the parties on potential material terms of the agreement but should not constitute a binding agreement itself. Another frequently used alternative or additional level of protection is to establish specific conditions to which, in any event, the potential transaction will be subject, such as completion of due diligence, execution of definitive agreements, antitrust or other regulatory approvals or the obtention of waivers from third parties. The above-mentioned is also the main setback for using term sheets in the United States. As noted by Lou R Kling and Eileen Nugent Simon, term sheets

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are usually clearly marked as being non-binding because ‘the most serious disadvantage of entering into a letter of intent [is] the risk that such document may be construed as binding upon the parties, leading to liability in damages if the transaction is not consummated’.[2]

In any event, and subject to the parties agreeing on the non-binding effect of the term sheet, in Mexico, term sheets have proved to be really effective in terms of transaction efficiencies, and are more frequently used by the more seasoned market participants, such as private equity funds and companies that are active in M&A transactions. A well-designed and sufficiently detailed term sheet can save months of negotiations as well as the deterioration of the relationships among the parties. An argument could be made that these efficiencies could also be attributed to the fact that, as previously mentioned, seasoned participants are the more frequent users, but in any case, a solid term sheet will pave the way for a smooth transaction.

Further, a term sheet may also save significant time and money for the parties, as the negotiation and execution of definitive agreements regularly involves each of the parties engaging legal, financial and tax advisers as well as due diligence by the buyer, among other aspects that may add to a substantial bill and no deal. Agreeing on a term sheet reduces the chances of a party being surprised on a major term of the deal further along the process.[3]

A well-designed term sheet will, at the least, include the following basic elements:

- the general economic terms of the deal, if the price will be fixed, variable, subject to adjustment or if any seller’s financing will be granted;
- basic indemnity terms, including its amount, duration, guarantees or escrow;
- conditions to which the transaction will be subject to, including regulatory approvals;
- basic representations and warranties expected from seller;
- general covenants, including non-compete and non-solicitation provisions;
- exclusivity provisions that prevent the seller to engage in negotiations regarding the asset;
- binding or non-binding effects, as well as any penalties for the defaulting party;
- choice of law and forum selection; and
- if applicable, the specific post-closing rights of the partners in the shareholders’ agreement or the vehicle’s by-laws.

As a general rule, the elements that will be further developed in the definitive agreements should be kept as concise as possible at the term sheet level, such as economic terms, indemnities and covenants, whereas provisions pertaining to the term sheet should be sufficiently detailed and leave as little room to interpretation as possible, such as exclusivity, binding effects and jurisdiction, as such provisions may in fact determine the extent to which a court of law grant relief or recourse to the parties.

2 Lou R Kling and Eileen Nugent Simon, Negotiated Acquisitions of Companies, Subsidiaries and Divisions (Corporate Securities) (1992).

3 Patrick A Gaughan, *Mergers, acquisitions, and corporate restructurings* – 5th ed (2011).

Given that the term sheet is the first document that outlines the deal, it is, by its very nature, flexible. However, the parties should find the right balance between the time spent on negotiating the term sheet and when it is time to turn into the definitive agreements. As previously mentioned, the term sheet should clearly establish some basic commercial aspects that are the basic premises of a potential mutually satisfactory transaction; however, as tempting as it may be to fall into the negotiation of the detailed aspects and wording which would be subject of the definitive agreements, that impulse should be avoided as it may defeat the purpose of the term sheet.

Non-binding effect versus specific binding provisions

Whenever parties start negotiating a term sheet, one of the biggest questions is if such preliminary documents would create binding obligations to consummate the deal or economic penalties to either party if they decided at a later stage they do not want to enter into definitive agreements or close on the deal.

There is a common misconception that such preliminary documents are always non-binding in nature. Regardless of the title of the document, term sheets, letters of intents or memorandum of understanding can in fact be binding, non-binding or partially binding and partially non-binding; it all depends on the intent of the parties and the wording of the document. Simply describing a document as a term sheet, letter of intent or memorandum of understanding is not enough to prevent it from being legally enforceable. If such document is sufficiently certain and all the other essential elements necessary for a valid contract are present, it may be enforceable, especially in civil law jurisdictions.

For such purposes, it is common practice to include language to expressly state that the terms and conditions included in the document are only indicative in nature and for discussion purposes only, and that the transaction is subject to, among others, due diligence process, final negotiation, signing of definitive agreements and regulatory approvals. A specific reference to which provisions, if any, are in fact meant to be binding is advisable. Customary terms and conditions that tend to be binding on the parties from the term sheet stage include expenses, confidentiality, exclusivity and escrow deposits.

A well-drafted preliminary document will clearly set forth which clauses are binding and which are non-binding, and set the tone for the negotiation of the definitive agreements to be drafted at a later stage. Almost inevitably, a document of this type will create rights and obligations to the parties, and therefore parties need to be sure that the term sheet properly reflects their understanding of the arrangements.

Given the nature of term sheets as a first step towards a definitive transaction, it is common to find clauses that require the parties to use their 'best efforts', 'reasonable best efforts', 'commercially reasonable efforts' or similar formulations towards achieving a specific milestone or result. In Mexico, as in other civil law jurisdictions, there is no legal definition to what may or may not constitute a 'best effort', 'reasonable best effort', 'commercially reasonable effort' or similar formulation, which results in a significant challenge to litigate a breach of this sort. Therefore, if the term sheet is governed by the laws of Mexico or another civil law Latin American jurisdiction, this language could be construed as the parties simply agreeing on doing something in good faith. Therefore, the parties should be made clearly aware that such covenant may be difficult to enforce under local law.

Non-disclosure and confidentiality agreements

Given that the term sheet is the first document that will be executed among the parties as part of a deal, documents include the confidentiality or non-disclosure provisions that the parties will be bound to throughout the negotiation and execution of the deal. These provisions, in addition to protecting the existence of the potential deal from leaking to the public, should also address the measures and restrictions on the use of the information that the potential buyer and its advisers will have access to as part of the due diligence process of the target. Generally, the receiving party should only be allowed to use the information for purposes of evaluating the proposed transaction, and not for any other purpose.

However, it has become also common to find stand-alone non-disclosure agreements (NDAs) aside of any term sheet that the parties may negotiate, in part following common law practices. This is advisable particularly when the parties expect the negotiation of the preliminary documents to take weeks rather than days, during which the information would not yet be contractually protected absent a stand-alone NDA. Also, confidentiality provisions and agreements tend to be more standardised throughout the market and should require less time until the parties are willing to be bound by their terms.

Owing to the fact that the harm caused from the breach of a confidentiality agreement may be hard to estimate, in addition to the damages and lost profits that a party may seek from the defaulting party, it is advisable that specific performance and equitable relief provisions are included in such agreements or clauses to allow the parties to contain any leaks as quickly as possible through injunctions, without limiting their ability from claiming compensation.

The definition of what constitutes 'confidential information' is highly negotiated. Counsel to the disclosing party will aim for a broad definition, generally covering (1) any information disclosed by or on behalf of its client, in any form (whether written, oral or otherwise) and irrespective of the information being specifically marked as confidential or not, (2) certain specific key elements, such as intellectual property, know-how, trade secrets, and customer and supplier lists, (3) the existence of the negotiations and status thereof, and the existence and terms of any preliminary agreements (including the NDA), and (4) any materials or notes prepared on the basis of or containing any 'confidential information', among others. Under Mexican law, there are no specific limitations as to what may be deemed as confidential information. On the contrary, Mexican law assumes that the disclosure of certain information (mainly certain intellectual property and information deriving from an employment relationship or other appointments) causes damage to the disclosing party and thus the law affords such information status of confidential information.

The term of the confidentiality duties is also a point of frequent discussion among the parties. While the disclosing party often requests confidentiality to run indefinitely, a term between one and three years is common. The disclosing party should make sure it has the right to demand return or destruction of any confidential information by the receiving party at any time (in particular upon termination of the NDA), typically subject to customary retention of records by the receiving party, as required by law or ordinary course electronic data back-up retention policies. The restrictions on the use of any retained information sometimes survive the termination of the NDA.

In addition to aiming to narrow the definition of confidential information and reduce the term of the NDA, counsel to the receiving party should make sure that specific customary carve-outs to what may be deemed as confidential information are included, such as information that has been made public through no fault of the receiving party, information in possession of the receiving party that was delivered by a third party without breach of a confidentiality duty, and information required to be disclosed under law or government or judicial order. In connection with the latter, the disclosing party should insist that the receiving party is allowed to disclose only the information that is necessary to comply with the relevant legal duty or order and is required to seek assurances that the information will be kept confidential. In any event, under Mexican law, the disclosure required by law or judicial orders is not deemed as a breach of a non-disclosure obligation, although the receiving authority has a legal duty to handle such information as confidential.

It is not uncommon to find competitors entering into transactions among themselves in the Latin American M&A market. The exchange of information among such participants poses significant business and legal risks for each party, including from an antitrust perspective, given that significant sensitive information may be transferred among the parties during the course of due diligence efforts. A key factor will be to accommodate to the specific actions that the local regulator demands or will be expecting to see, which may be specific in terms of form and substance. For example, although the Mexican Antitrust Commission has in place specific guidelines that the parties must follow for these cases, there have been other practices that have been successfully implemented in the market. The first step is for the disclosing party to identify its sensitive information. In a second stage, the parties should analyse the ways in which such information may be delivered to the receiving party, in an useful format, without revealing the sensitive aspects. For example, certain financial and business information may be delivered in aggregated form, instead of providing separate information for each channel, product, supplier or customer. Finally, all the other sensitive information should be placed in a clean room to which only the receiving party's external advisers have access and they will have specific NDA agreements in place allowing them to disclose such information to their client only in a way that maintains the sensitive aspects confidential. Entering into specific clean team agreements is sometimes mandatory and often advisable.

It is also not uncommon for NDAs to include non-solicitation provisions with respect to certain employees of the targeted business. A prospective buyer will often have access to key employees of the target. Therefore, the disclosing party might be concerned that the buyer may attempt to poach such employees if a transaction is not consummated, especially if such prospective buyer is a competitor. Common exceptions to such provisions include hiring as a result of unsolicited request for employment by an employee or as a result of a general solicitation (including advertisement) that is not directed specifically to any employees covered by the non-solicitation provision.

Exclusivity agreements

Although entering into a separate exclusivity agreement is feasible and is an alternative available to the relevant parties in M&A transactions in Mexico and generally throughout Latin America, it is common practice for exclusivity provisions in connection with M&A transactions to be built in directly into other preliminary agreements of the transaction, such as, depending on the structure of the transaction, the term-sheet, letter of intent, memorandum of understanding or the NDA. In most cases, the exclusivity clauses and provisions included in the preliminary agreements are expressly made to be binding and are enforceable with respect to the parties thereto.

Through an exclusivity agreement or an exclusivity clause included in a preliminary agreement, which is also commonly referred to as a no-shop clause or no-solicitation clause, the potential buyer will generally look to obtain assurance from the seller that there are no existing contractual arrangements or undertakings with any other third party in connection with the acquisition (or similar transaction) of the target company, as well as assurance that the seller is not engaged in ongoing negotiations or discussions with any other potential buyers in connection with the acquisition (or similar transaction) of the target company.

A strong and effective exclusivity agreement or exclusivity clause will typically establish certain commitments of the parties thereto, which will be enforceable during the agreed upon exclusivity periods set forth thereunder, and that typically include (1) the commitment of the parties to deal exclusively with each other for the purpose of drafting and negotiating the definitive agreements for the relevant transaction, and (2) the commitment of the seller and the target company to avoid soliciting or negotiating any offer or proposal from, or engaging in any discussions or negotiations with, or providing any information to, any third party (other than the buyer or its affiliates, shareholders, partners, officers, employees, directors, agents, advisers and representatives) in connection with any inquiries or proposals for acquiring the target company, its assets or its business or any other transaction that is similar, inconsistent, competitive or conflicting with the relevant transaction with the potential buyer. Moreover, it is common practice for exclusivity agreements and exclusivity clauses included in preliminary agreements to establish that, if the seller or the target company receives any unsolicited offers or proposals for the acquisition (or similar transaction) of the target company from any third party, the seller and the target company will have the obligation to advise that third party that it is engaged in exclusive discussions with the potential buyer, and that it is precluded from proceeding with any such third party. If the target to a transaction is publicly traded, especially in a common law jurisdiction, additional provisions may need to be inserted as exceptions to the commitment to the particular transaction, including as a result of the requirements that board members satisfy their fiduciary duties, by, among other things, seeking to maximise shareholder value when a company is in play, as well as other legal provisions relating to tender offers.

The exclusivity periods agreed upon by the parties to M&A transactions and set forth in the corresponding exclusivity agreements or exclusivity clause of preliminary agreements will typically range from one to six months. Although the exclusivity periods may vary depending on the jurisdiction and specific characteristics of the transaction and the target company, its assets or business, the range mentioned above is a good rule of thumb for transactions of this type. Often, the parties will agree that such exclusivity period be consistent with the period granted to the potential buyer for purposes of performing the due diligence process of the target company and, in some cases, it may even be longer. While negotiating the exclusivity period in an exclusivity agreement or exclusivity clause in a preliminary agreement, the potential buyer will typically want to negotiate for a longer exclusivity period, while the seller will want a shorter period. It is also common practice for the parties to the exclusivity agreement or to the preliminary agreement including such exclusivity clause, to establish the ability to extend such exclusivity period upon mutual agreement of such parties.

Moreover, solid exclusivity agreements or exclusivity clauses afford important benefits and are overly convenient from the perspective of the potential buyer due to the leverage afforded to such buyer, considering that the seller will be prevented from searching or soliciting alternative transactions with more favourable terms throughout the exclusivity period. Failure to limit or prevent the ability of the seller to search or solicit an alternative transaction by means of exclusivity provisions could trigger a bidding war for the target company if there are various interested parties, which could ultimately result in a higher transaction price for the potential buyer.

From the perspective of the seller of the target company, that seller should look to avoid an exclusivity agreement or exclusivity clause establishing a long exclusivity period. Avoiding a long exclusivity period is especially important from the perspective of the seller if there is a risk that the potential buyer will walk away from the transaction upon completion of the due diligence process.

Owing to the binding nature of exclusivity agreements and the exclusivity clauses included in preliminary agreements for M&A transactions, if any party breaches the exclusivity provisions, the breaching party will be liable to the non-breaching party. In many cases, the breaching party, in addition to any remedies afforded under the applicable law, will typically have the obligation to reimburse reasonable and documented business expenses incurred by the non-breaching party in connection with the negotiation of the transaction, generally including fees and expenses of professional advisers. In certain occasions, depending on leverage and jurisdiction, other liquidated damages in the form of a termination fee may be discussed.

Cost-sharing agreements

M&A transactions may involve, in addition to commercial, financial and legal stream works, several challenges from both accounting and tax perspectives when cost-sharing components need to be addressed by the transaction parties.

In those cases, the parties executing M&A transactions should agree on general terms that will govern their cost sharing allocations before closing the transaction (including on structuring, formation of legal vehicles, filing fees, among others), which should be negotiated, to the extent possible, at an early stage and also be included in the relevant term sheet, letter of intent or memorandum of understanding mentioned above.

In M&A transactions with cost-sharing components, it is advisable for the transaction parties to enter into a cost-sharing agreement (CSA) or, otherwise, include cost sharing clauses in the relevant agreement, whether it is a stock purchase agreement, an asset purchase agreement, or any other type of agreement.

An independent CSA is an agreement entered among business enterprises to share the risks and costs involved in developing, producing or transferring assets, rights or services, and to determine how the interest will be allocated among the transaction parties, as well as how the costs will be shared among them, creating direct economic benefits for such parties.

CSAs are usually used to develop, produce or acquire assets or rights, and to execute specific services. This type of contract is characteristic with an exposure to overall risks that can be shared within two or more companies that otherwise would not have invested any resources on their own.

One of the main characteristics of a CSA is that relevant assets are owned by an enterprise, but the costs and risks of development, and the right to exploit those assets is shared with a cost share participant, usually an affiliate or a subsidiary of such company.

Different types of CSAs can be executed in M&A transactions. The CSAs and cost-sharing clauses more commonly used in Mexico and in other Latin American countries concern the development of intangible assets. CSAs and cost-sharing clauses are common in transactions regarding the development of industrial and intellectual property rights such as software, patents, utility models among other intangible assets.

Also, enterprises usually enter CSAs when there is a common need from which the transaction parties can mutually benefit. However, it is important to take into consideration that when two enterprises are related parties or are affiliates of the same corporate organisation, the arm's-length principle should apply. That principle states that the proportionate share over all the party's contributions must be consistent with the proportionate share of all the expected benefits to be received by the transaction parties under such CSA.

In addition, CSAs are similar to joint venture agreements. However, the difference between a CSA and a joint venture agreement lies in the fact that CSAs are used only for developing, producing, or transferring rights or assets, or for executing specific services, and for sharing the costs and risks derived therefrom among the parties, while regular joint venture agreements are used for earning income as a result of the contribution of two or more enterprises.

In some countries, CSAs are described as a form of joint venture agreements. However, one of the advantages of CSA compared to variable royalty agreements such as joint ventures is that CSAs may provide to taxpayers with unique opportunities to receive economic compensations from tax authorities that impose limitations on royalty payments.

Another advantage is that the parties to a CSA contribute their own resources (whether human, financial or both) and their know-how for the development of an asset (normally intangible assets) or the execution of a specific service, and the ownership of the results are shared among the parties. This means that each party has the right to exploit the results without paying any royalties to any other party for such exploitation.

Such exploitation rights are recognised by the Organisation for Economic Co-operation and Development (OECD), of which Mexico is a member. In that regard, the OECD has recently released new guidelines regarding CSAs, as well as the cost sharing and price transferring derived from the execution of such type of contracts (the Guidelines).

The purpose of the Guidelines is to ensure, among others, consistency in the valuation and pricing of assets and services, whether such assets and services are associated with a CSA, as well as to ensure a common framework regarding the characteristics of a CSA, the risks involved in the transaction, the assets being transferred or the services being rendered, and the documentation requirements of the CSA.

Owing to its nature and characteristics, CSAs and cos-sharing clauses included in the relevant agreements represent a competitive and advantageous mechanism when entering M&A transactions, whereby cost sharing and price transferring components need to be addressed by the transaction parties.

12

Due Diligence: A Practical Guide to Deals Involving Latin American Targets

Diego Pérez-Ordóñez[1]

In Latin American countries – particularly in Ecuador – due diligence processes usually have both legal and 'diplomatic' implications. Latin American targets are often family-owned or governed by a long-standing management team; therefore, due diligence usually poses practical challenges in addition to purely legal challenges.

When dealing with family-owned targets, the administration and management of companies is driven by personal relationships, trust and unwritten uses and customs. Buyers' counsel needs to navigate the art of trying to find and propose ways to understand and mitigate risks without involving, if possible, the implementation of unnecessarily invasive actions or policies that may irritate the controlling family or families. The latter tend to consider due diligence (often an invasive exercise) as questioning their good practices and interfering with their daily tasks, and the finding of risks as an accusation of incorrect conduct.

In family businesses, due diligence can feel like stepping on eggshells and requires 'people skills' in equal measure to legal tools. Transactions have often faced difficulties or fallen through just as much due to the finding of risks as due to a lack of tact or effective communication strategies by the buyers or their counsel. When working with sellers who are a family or family group, it is critical to explain that the suggested actions are consistent with or close to the best practices of international companies.

In companies governed by long-standing management teams, the due diligence process is often perceived by management as a threat or an unwarranted assessment of their work.

Conversely, transactions between similar and more sophisticated companies, in terms of the due diligence process, are usually more in depth and aggressive as the negotiation is

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mostly focused on discussing the significance, likelihood of materialisation and quantification of risks. Limitation on the information made available by a target for review is usually justified by commercial or antitrust concerns of the sellers.

Notwithstanding the political issues to be considered, as set forth above, due diligence processes – including those undertaken regarding Latin American targets – have certain common issues, regardless of the identity of the parties, which we will explore below.

Due diligence and representations and warranties

M&A practice in Ecuador distinguishes the fundamental representations and warranties from the run-of-the-mill, operational or general representations and warranties. The former, in SPAs, are confined to the ownership of the shares, the due organisation and legal operation of the target company (or companies) and the capacity and legal authority of the parties and signatories and, in recent years, often, the application of international compliance and anti-corruption rules. In the case of asset transfers, these concern the good title for, and absence of encumbrances on, such assets.

Regardless of the amount of diligence parties can do in connection with fundamental representations, from a negotiation perspective, the buyer will push hard to have any liability arising out of a breach of fundamental representations be covered by the sellers up to no less than the amount equal to the total price (under the argument that this is precisely the aspect that distinguishes the fundamental representations and warranties from the ordinary representations) and the seller will try to reduce the scope of its assumed risk by showing that the target has all its documentation in order and that there is no doubt as to the integrity of the shares or assets being purchased.

Disclosure plays a critical role in connection with one of the most important battles in a transaction process: non-fundamental or operational representations and warranties. The buyer will propose that these are as broad, generous and extended as possible, while the seller seeks to narrow them. A reasonably thorough and technical examination with the advice of experienced attorneys gives the buyer invaluable information to understand the strengths and weaknesses of the target, possible existing and expected issues and contingencies that may impact its value, its ability to continue to operate and the extent of assumed liabilities. All of which have to be reflected in the negotiation of price, contractual terms, conditions and guarantees. The seller's strategy will often revolve around the timing and level of detail of the disclosure of information over the course of the due diligence review, in putting together the disclosure schedules and seeking to reduce anxiety about the risks found from a legal and financial perspective, to seek to minimise any closing risks, pricing pressure from buyer or increased post-closing exposure.

Any experienced attorney or adviser knows that much of the energy in seeking to sign and close transactional documents is invested in negotiating the representations and warranties, the applicable law, the liability regime and certainty of closing.

The more comprehensive a due diligence review is, and the more information made available to the buyer and its advisers, the better the buyer will understand the risks the underlying business is facing, and the better the parties will be able to discuss risk allocation with greater context. As part of that risk allocation strategy, the seller may request the inclusion of anti-sandbagging provisions in the agreement, where the buyer waives the right to be indemnified for risks or contingencies known to buyer prior to signing or closing. This provision forces buyer to discuss these issues as specified indemnities with the sellers prior to the execution of the agreement or to consider such issues in its assessment of the pricing of the deal. Critical to an anti-sandbagging provision is the definition of both the timing and the manner in which the buyer 'acquired' the knowledge.

Due diligence and disclosure schedules

Disclosure schedules are instrumental in the allocation of risk between the parties. Some sections to the disclosure schedules are exceptions to representations and warranties and other sections include information (usually in the form of lists) with respect to which certain representations and warranties are made. The seller will usually want the former to be broad and over-inclusive, to shift the risk to the buyer, and to limit the latter to what is strictly necessary, to keep the representations as narrow as possible.

The structuring and preparation of the disclosure schedules is often far from routine for the target representatives involved in the process, and in the case of family-owned targets, it may prove challenging to gather all information necessary for the disclosure schedules to be completed accurately.[2] On the one hand, the seller's counsel normally aims to be over-inclusive in the disclosure schedules (in which the seller discloses and acknowledges the existence of certain risks) to avoid liability for breach of representation, or worse, concealment or failure to disclose, but without affecting the price of the transaction and without assuming unnecessary commercial exposure. On the other hand, buyers will advocate for certain disclosure schedules (especially those that are exceptions to representations and warranties) to be limited in scope, specific in wording and contain only disclosures of known contingencies, as opposed to generic risks (it is common for the buyer to require the seller to disclose all issues required on each schedule, and not allow a disclosure in a single schedule *vis-à-vis* a specific representation and warranty, to be considered as a disclosure with regard to all other representations and warranties). In any case, the review of the disclosure schedules prepared by the sellers are an invaluable tool to confirm any findings of the due diligence review, and to point to possible liabilities or contingencies which may not have been detected.

Much of the M&A attorney's expertise and experience comes into play in this chess game of allocation of liabilities, which has contractual implications, and often has litigation implications. Additional contractual tension arises between, on the one hand, the seller's desire to argue that the buyer has been granted access to all relevant information and has independently assessed the risks of the business with the support of sophisticated advisers and is equipped to make an informed investment decision considering any contingencies and liabilities, and, on the other hand, the buyer's desire to argue that it has relied in good faith on the information the seller expressly disclosed in the schedules.

The disclosure schedules may be overlooked by some and considered as low value, routine and irritating work. In practice, their importance lies in the fact that they may

2 See Chapter 5, 'Mergers and Acquisitions Involving Family-Owned Targets'.

reverse terms included in the face of the transaction agreement, may shift the allocation of risks among the parties for known and unknown issues, and can alter the damages and degree of liability of the parties. The disclosure schedules' impact on the bring down of representations and warranties may also affect the certainty of closing (especially when the agreement allows for the disclosure schedules to be updated during the period between signing and closing), and may even affect various levels of pre-contractual liability or *venire contra factum proprium* theories (application of good faith or estoppel).

The use of legal technology in due diligence efforts

A key technological tool for the due diligence process has been the use of virtual data room platforms, which allow the buyer and its advisers to conduct a remote review of all relevant documents, and allows the seller to keep track of the documents reviewed, set up specific confidentiality and security restrictions for sensitive documents and promptly answer any questions though the Q&A features. The use of this tools is widespread in Latin America, and the physical review of documents has become the exception.

The use of digital platforms (including those with artificial intelligence) is increasingly common in Ecuador and the region. Particularly in matters in which recurring processes, repeated information or key conducts must be detected, as in compliance or competition. We have also seen the use of these tools to review serial documents and conduct the analysis of contracts, for example, in detecting key contractual clauses (such as exclusivity agreements or change of control clauses) that may have an impact on the viability of the transaction or on the mechanics for the closing of a deal.

Other areas still require manual analysis work to find strategic information, usually regarding labour law, litigation, intellectual property and regulatory analysis. Technology is also very useful in tax and financial matters for detecting numerical inconsistencies, recurring processes or trends.

Common due diligence findings for Latin American targets

Due diligence findings will vary by target, by country, by industry and by level of thoroughness of the due diligence process and access to information. However, certain areas tend to yield a higher number of issues upon a rigorous review, including the following:

Taxes

These include income tax assessments by the tax authority, and detailed administrative proceedings with high accounting content in which counsel analyses the target's accounts and practices in order to find inconsistencies that may lead to potential higher tax payments being due. Aggressive tax structuring and planning are frequent and tend to result in high-value potential contingencies given the long-term potential violations and the possible imposition of fines and interest by the tax authorities. In certain sectors, including beverage and telecommunications, these examinations also focus on analysing the management and calculation of Excise Tax (ICE), which is very frequently a source of litigation and discord between the state and the companies.

The key to a robust tax due diligence is a combination of an experienced legal team and a financial-accounting team who can exchange opinions and jointly assess the findings. Limiting the analysis to a purely formal study of compliance with laws and regulations is not normally enough.

Labour and employee benefits and compensation.

The most frequent issues tend to concern unfair dismissal – a very costly way to cut staff in Ecuador – in cases where there is an employment relationship with an officer who exercises legal representation (notably the general manager), sham labour relationships (and the resulting indemnification risks), meticulousness of supplementary and additional payments (extra hours or vacation pay), the existence of bonuses or golden parachutes for executives, allegations of harassment and, in recent years, policies and good practices for managing personal data of the target company's employees. Clients are increasingly requesting the quantification of labour risks that, in view of the constitutional rule for a profit-sharing regime,[3] often has tax and accounting implications. Good communication between the labour and tax teams is of the essence.

It is also common for the company to engage private contractors or temporary personnel agencies to perform certain duties. Such contractors, personnel or the labour regulator may claim that they should be considered as employees, and require they are paid all benefits to which employees are entitled. It is imperative to detect if these cases exist in a potential target company during the due diligence review, as they are a common source of liabilities after closing.

Competition regulation.

It is advisable to conduct a series of interviews with key executives to detect or analyse competition practices during the due diligence process. Experience shows that even when contracts are impeccable and policies are wonderfully drafted and communicated, commercial pressure tends to cause both intended and unintended violations to competition rules. In almost all cases, findings in this area arise more from the interviews with the executives than from reviewing documents provided directly or via a data room. Also, though it can be a delicate task and the sellers may even find it invasive, it is necessary to understand the competition practices of the target, as well as potential antitrust concerns with the combined market share of the buyer and the target. The latter can be the biggest issue to obtaining required regulatory approvals without which a deal cannot close. This is particularly important in jurisdictions in which awareness of competition matters is still forming, such as in Ecuador, and is much more important when the competition authority may also be in the process of being formed, is in charge of, and applies very severe and punitive laws.

Anti-bribery and corruption compliance.

Corruption, money laundering, conflicts of interest and violations of transparency best practices have become a very significant issue for acquirers. Due diligence and corporate

3 Ecuadorian law requires companies to share 15 per cent of their profits with their employees.

best practices are critical to limit exposure with regard to these issues. Conducting a thorough compliance and anti-corruption analysis is even more essential in times of political, social or healthcare crises, such as the covid-19 crisis.[4] The use of digital tools and through the identification of red flags are key to detect recurring suspicious practices or purposeless contracts which require a closer look by compliance experts; therefore, it is important to ensure a fluid exchange of information between the compliance, competition and tax teams to identify these risks promptly.

Environmental

Environmental matters are more important than ever in Ecuador given the constitutional mandate whereby there is no statute of limitations for lawsuits or claims for environmental damages. For both the purchase of shares and acquisition of assets, the analysis must not be limited to compliance with regulatory formalities or the existence of permits. Instead, technical examinations are recommended to determine potential impacts and compliance with policies and guidelines. It is also necessary to note that the different districts of Ecuador usually have different regulatory norms that have a bearing on environmental issues.

Risk mitigation

The due diligence process should be used as a tool for the parties, especially buyers to ensure the purchase price factors in any features, contingencies or risks of the target. Seasoned counsel will reflect the allocation of such risk as well as covenants to seek to reduce or mitigate the materialisation of risks in the period between signing and closing, and post-closing. The terms of indemnity that are established in the agreement are another tool to mitigate and allocate risk; in that sense, the parties may choose to limit the maximum exposure of the indemnifying party as well as a minimum amount of losses required for a party to be indemnified (through the establishment of a de minimis amount, under which the losses are not indemnifiable – or a basket, which establishes a threshold for aggregate losses that must be met before such losses are indemnifiable, and may be structured as a deductible or a tipping basket).

Statutes of limitations overview

The statutes of limitations in place in the jurisdiction where a target operates will be instrumental to determine the scope of review during the due diligence (there is no need to review issues when the statute of limitation has already expired) and will also drive the contractual discussion for the survival of the representations and warranties of the sellers (where buyers push to be covered and indemnified until any contingency expires, and sellers push to reduce as much as possible the period in which they remain liable after closing).

The statute of limitation that applies in each case may vary significantly depending on the jurisdiction within Latin America where the target operates, and thus the scope of the review during the due diligence and the contractual discussion for the survival of the

4 See Chapter 1 of this guide for further analysis on the impact of the covid-19 pandemic on M&A in Latin America, including with respect to due diligence.

representations and warranties of the sellers will also vary significantly between different jurisdictions. In that sense, for illustrative purposes, we have included the different statute of limitations for tax issues, as described on the Inter-American Center for Tax Administrations (CIAT) Tax Administration Magazine:[5]

Jurisdiction	Statute of limitation for tax issues
Argentina	Five years (registered taxpayers) or 10 years (non-registered taxpayers)
Bolivia	Four years (registered taxpayers) or seven years (non-registered taxpayers)
Brazil	Five years
Chile	Three years (after a complete return is filed) or six years (if no return is filed or after an incomplete return is filed)
Colombia	Five years
Costa Rica	Three years (registered taxpayers) or five years (non-registered taxpayers)
Cuba	Five years
Dominican Republic	Three years
Ecuador	Three years (after a complete return is filed) or six years (if no return is filed or after an incomplete return is filed)
El Salvador	Three years (after a return is filed) or five years (if no return is filed)
Guatemala	Four years (registered taxpayers) or eight years (non-registered taxpayers)
Honduras	Five years
Mexico	Five years (after a return is filed) or 10 years (if no return is filed, if the return is filed late, or if the taxpayer has no formal accounting)
Nicaragua	Four years (after a complete return is filed) or six years (if no return is filed or after an incomplete return is filed)
Paraguay	Five years
Peru	Four years (after a return is filed) or six years (if no return is filed)
Uruguay	Five years (after a return is filed) or 10 years (if no return is filed, if the return is filed late, or if the taxpayer is not registered)
Venezuela	Four years (after a return is filed) or six years (if no return is filed, if the taxpayer is not duly registered, if the tax authority is unaware of taxable activities undertaken by the tax payer, if the tax payer has undertaken taxable activities abroad, or if the taxpayer has no formal accounting)

In that sense, Federico Scheffler and Andrea Trejo of Galicia Abogados, in an article in the *International Tax Review*, state – in relation to Mexico, but applicable to all of Latin America:

> *As fundamental representations imply a greater liability for the seller upon breach, often their survival period is matched to the applicable statute of limitations of the underlying claim (e.g.*

5 Mendes, Sérgio Rodrigues, Los plazos para determinar la obligación y para exigir el pago de las deudas tributarias, en los países miembros del CIAT, Revista de Administración Tributaria CIAT/AEAT/IEF No. 34, December 2012 (https://www.ciat.org/Biblioteca/Revista/Revista_34/Espanol/7-los_plazos_para_determinar_rodriguez.pdf).

> *typically around five years with respect to tax claims), whereas non-fundamental RWs survival periods may last for varying periods of time, more commonly between 12 and 24 months.*[6]

The topic of statutes of limitations, therefore, is instrumental, for the strategy of the buyer in any transaction (especially on the due diligence review and the contractual negotiation). The statute of limitation regime under Ecuadorian law has several nuances and local M&A practice is thus complex with multiple contractual considerations.

It is complex because the different variations of statutes of limitations, which in Ecuador are divided by subject, are regulated by different bodies of law (e.g., the Employment Code, the Civil Code, Law for the Control of Market Power and the Constitution), which, over the years, have been tackled and ruled on by different judges depending on the subject matter in different eras and circumstances. It is a significant issue since the legal norms that regulate the statutes of limitations were issued decades or even centuries apart, meaning there is no uniform case law on the application of such limitations. So, for example, the statute of limitations for contractual matters is normally governed by the Civil Code (which dates from the mid-19th century), labour is governed by the Employment Code (the first version is around 80 years old and is considered anachronistic and inflexible), competition rules date back to 2011 and the regulation of no statute of limitations for environmental damage was added in the 2008 Constitution.

This variety in relation to the statute of limitations has multiple effects and considerations for the due diligence process on the one hand, and the negotiation of contractual terms and conditions on the other hand.

The multiplicity of limitations scenarios generally requires the use of several dedicated and specialised teams in the due diligence process. From the perspective of commercial contracts and contracts governed by the Civil Code, if there is no express agreement to the contrary, the common obligations will expire in 10 years and executive or enforceable obligations will expire in five years. The distinction made by the Civil Code is very important: common obligations are considered those that do not include a duty to pay an enforceable and due fixed amount, that is, for the most part, the ordinary contractual obligations and benefits. Whereas executive or enforceable obligations are those in which, given the nature of the benefit, the debtor has assumed an obligation that is no longer contested precisely because it is for a fixed amount and has been declared due and payable by the creditor. In the first case, when a dispute exists, the judge is asked to acknowledge the existence of a right in the ruling; in the second case (summary collection proceeding), the judge is asked to enforce the payment or performance of an obligation.

This civil distinction, which may apply to commercial contractual relationships, is very important in connection with the due diligence process, as the results of this examination will necessarily affect contractual documents. In the case of share purchase agreements, this civil law distinction is more important because the buyer will take on the target company. The most typical scenario in a negotiation will be the sellers advocating for the

6 https://www.internationaltaxreview.com/article/b1mky5jd3wcp61/tracing-the-growth-of-representations-and-warranties-insurance-in-mexico.

contractual reduction of statute of limitation rules, while the buyers will push to be covered until the statute of limitation has expired or even add more time to the period established under legal norms and to reduce or defer the price using fiduciary mechanisms or, in case of greater risks, using withholding mechanisms such as holdbacks.

For labour matters, the statute of limitations is three years after the termination of the employment relationship. This seemingly simply rule also creates contractual complications, notably for employer obligations that are not necessarily tied to the severance, such as the employer-paid pension or the employer's obligation to create a reserve fund. For these two aspects, the contractual negotiations resulting from the due diligence process tend to focus on the creation of fiduciary guarantee mechanisms or the withholding of a portion of the price. Evidently, this aspect is vital in companies with long-standing labour forces.

In the tax field, the statute of limitations also has relatively complex due diligence and contractual implications. Here it is more to do with the expiration of the taxman's powers of assessment. In other words, the tax authority losses its power to assess tax payments due to the passage of time, without the taxpayer needing to make a claim (this is a fundamental difference with the statute of limitations). In tax matters, this expiration applies in two scenarios: three years after a complete tax return is filed (taxes, fees or special contributions) or after six years if the filing was incomplete. The due diligence challenges and contractual implications occur in the second scenario: the tax authority tries to argue that the taxpayer has filed an incomplete tax return, so that three years can be added. This is why it is advisable in M&A examination processes to conduct an analysis for the six prior fiscal years. Now, particularly from the seller's side, this analysis can create resistance and arduous contractual discussions. If the six years are not applied, the parties usually agree a period of four to five years to release funds held in escrow or holdback, without prejudice to the agreed upon specified indemnities.

A separate matter is the statute of limitations in competition matters (in reality, also the expiration of the regulator's powers). The relevant legislation states that the power of the Competition Authority (SCPM) to begin an administrative proceeding at its own initiative or at the request of a party expires four years after (1) it is made aware a violation has been committed or (2) for recurring violations, after the date these ceased. When due diligence processes are concerned, the detection of potential competition violations is much more complex that in other areas. Some reasons for this are that, usually, harmful conduct is not recorded in contracts or written documents; it is common for sales forces, sellers and distributors to act outside of the companies' policies, and the whistle-blowing regime in Ecuador is imperfect and questionable as regards its guarantees. Given the above, it is advisable for competition-related due diligence processes to be coordinated with those for compliance, so that risks can be detected from both fronts and using digital tools. The second complex issue is the absence of case law or guides by the authority regarding recurring violations that are mentioned in competition law, notwithstanding hardcore conduct.

Lastly, the Ecuadorian Constitution states that legal actions to prosecute environmental damage are not subject to any statute of limitations. In practical terms, this means that a third party (including the state itself) could bring actions or claims for environmental damage at any time, regardless of how much time has elapsed. Two further constitutional mandates must be added to this: the *in dubio pro naturae* principle and the establishment of strict liability of the accused. So, in due diligence processes it is very important to have environmental technical experts, whether buying shares or assets.

Sellers' due diligence

Sellers and targets may choose to invest in internal processes to identify their own operational risks and weaknesses in order to address them prior to a due diligence review by a potential buyer (known as a vendor's due diligence), and they may also choose to conduct a due diligence of the buyer to analyse the buyer's creditworthiness and reputation, the risk of not obtaining required regulatory approvals, Anti Bribery and Corruption and Anti Money Laundering compliance by buyer, etc., all of which will ensure that there are no surprises at the moment of closing or post-closing, and thus avoid costly litigation.

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Interim Operating Covenants and Closing Conditions

Martín Cerruti, Geraldine Ifrán and Santiago Fontana[1]

In corporate acquisition transactions, there may be a period between signing the purchase agreement and closing the acquisition, that is, when the transfer of the target becomes effective. Transactions can be structured so that signing of the agreement and closing do not take place simultaneously for various reasons, such as the need to obtain corporate approvals, as well as consents and approvals by third parties, government regulators in the case of industries subject to oversight, and antitrust authorities, among others. During that interim period, the parties, and more significantly the seller, assume obligations to perform and abstain from performing certain acts, which are extensively negotiated and generally referred to as interim operating covenants.

Sellers, purchasers and their advisers are interested in this interim period and how it may affect the certainty of the closing. Purchase agreements should include appropriate conditions to closing and termination rights that should balance certainty of closing and the parties' right to withdraw from the transaction under appropriate circumstances, when specific aspects of the transaction are impacted or affected.

Third-party consent and other corporate matters

In certain cases, it is necessary to obtain the consent of a third party with whom the target maintains a significant contractual relationship. The target company may have contracts with clients, suppliers and lenders that include change of control clauses (with different scopes and implications) that give those parties the right to unilaterally terminate their agreements in the event of a change in ownership structure. If the contracts are material for the target, the parties may decide to defer closing for purposes of obtaining the respective third-party consents during that interim period. In some cases, the agreement may include

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a condition to closing to that effect. However, counsel must consider the risk of giving such third parties more leverage than is warranted by allowing them to delay or preclude the M&A transaction

Additionally, there are cases in which closing is deferred because the parties need to obtain corporate approvals, implement internal restructuring, carve out business lines or assets from the business to be transferred. The purchase agreement may include completion of such actions as a condition to the obligation of buyer, seller or both to consummate the closing, though in some cases, a pre-closing covenant and acknowledgement may suffice.

It is also possible that the parties may become aware of an imminent event that could have a material impact on the price (e.g., the rendering of a judicial or arbitral decision, discussions as to a potential change in the local regulations applicable to the industry, and measures by other countries that may pose barriers for entry to usual export destinations). In those circumstances, the parties may decide to defer closing until such event takes place (or is permanently precluded) rather than turning to escrow accounts or price clawback mechanisms.

Regulatory approvals

The regulation of private activity involves, among others, the creation of rules through the legislative function, as well as administrative tasks geared to controlling, assisting or channelling the conduct of private parties, for the purpose of ordering and fostering the development of private activity, including through: recording (registries), promoting (privileges, subventions, subsidies), guiding (controls, authorisations) and supervising (inspections).

There are industries where, given the importance of the public interest involved, the government alters the natural and spontaneous conduct of the market by imposing certain demands or requirements for entry and operation of economic agents.

In those industries, a change of control of a supervised entity or the transfer of a supervised business (in the case of asset deals) usually requires obtaining authorisation from the relevant government regulator, which is granted once the latter has carefully reviewed the professional, technical, economic and other background of the new agent seeking to enter the market or enhance its position within that market. Government oversight may be a matter of lawfulness (compliance with the rule) or of merit (opportunity and advisability).

The same is true in the case of concession agreements executed with the government when the transaction involves a change in control of a company that contracted with the government and whose background was taken into account by the latter to award the concession to that particular company. Therefore, government agency authorisations are often required for the shares of the concessionaire entity to be sold.

In Uruguay, in line with regulations throughout the region, various industries require authorisations from the respective regulators for the transfer of shares of regulated companies. The list of such industries includes the financial sector (including banks, finance companies, etc.), insurance companies and telecoms, among others.

For example, in recent years, the Uruguayan financial market has had various cases of transfers or attempts to transfer shares of regulated entities that involved deferred closings in order to obtain authorisations by the Central Bank of Uruguay (BCU). For the purposes of evaluating requests for share transfer authorisations, BCU assesses matters of law, opportunity and advisability. That process requires the submission of extensive information that includes economic, technical and business reputation background of the purchaser, as well as business plans with respect to the target company. Moreover, BCU verifies that, in the recent past, the party that will come to hold effective control of the target has not had significant growth, either organically or inorganically (via acquisitions), that there is a memorandum of understanding between the regulator at the place of origin of the party who will exercise effective control and the BCU, and that the regulator in the jurisdiction of origin exercises consolidated supervision.

Consolidated supervision is a consequence of the practical reality that financial sector regulators face with institutions that are part of internationally active and highly diversified groups, which conduct interrelated transactions using capital and resources of different members of the group. Given the concern that a financial institution may be negatively impacted by losses suffered by other entities of the same group, banking regulators internationally – including the Central Bank of Uruguay – use consolidated supervision, where a single supervisor oversees all entities of a group to obtain an overall vision of the group's strength and of all risks that may affect it as a whole and, hence, the local entity as well.

In cases of nontraditional players in the financial sector, including investment funds, the set of strict requirements has on occasion made it impossible to reach closing and caused exclusion of the Uruguayan portion of a regional or global target business to be transferred. While only a couple of financial sector transactions were not achieved over the past 10 years, the number is relevant in a financial market as small as Uruguay's.

Antitrust authorisations

Until April 2020, Uruguay was one of the few exceptions to the antitrust control regimes in place in Latin American countries. Under the system in effect until then, concentration notices by companies to the Uruguayan Antitrust Commission (Comisión de Promoción y Defensa de la Competencia) were only for informative purposes, given that unless the transaction would lead to a 'de facto monopoly' (understood as 100 per cent of the relevant market), it did not require authorisation by the Uruguayan Antitrust Commission for perfection.

New Uruguayan regulations (Law 19,833 and Decree 194/020) repealed that regime and moved to a prior control regime that is more generally applied in the region and globally. Parties to transactions that exceed a certain turnover threshold – a combined local turnover over approximately US$65 million in any of the last three fiscal years – must obtain Uruguayan Antitrust Commission approval prior to closing. Local turnover must include the parties' turnover 'in Uruguayan territory', including their parents, controlled and sister companies, also including taxes.

As for time frames, which are vital for M&A transactions subject to obtaining government agency authorisations, the regulations provide that upon a request for authorisation the Uruguayan Antitrust Commission will have 60 days to issue its decision, and it may authorise the transaction, deny it or subject it to fulfilment of certain conditions. Until the Uruguayan Antitrust Commission considers that the parties have fulfilled their duty of filing correct and complete documentation, it can request further documents and clarifications from the parties. Therefore, in practice this means that the 60-calendar-day period can be de facto extended by the Commission.

Non-response by the Uruguayan Antitrust Commission upon lapsing of the said term shall be interpreted as tacit authorisation.

If the parties close the transaction before obtaining regulatory approval, the Uruguayan Antitrust Commission can impose economic penalties for 'gun-jumping'. In addition, the transaction may be considered an invalid contract from a contract law perspective.

These amendments to Uruguayan regulations became effective as of April 2020 and hence there are still no administrative precedents to inform their enforcement. The Uruguayan Antitrust Commission is currently working on additional merger control guidelines that should provide more clarity around the enforcement of the new regime.

Application of antitrust rules until closing

When the signing and closing of transactions are not simultaneous, the parties are subject to general antitrust rules prohibiting anticompetitive conduct until closing. The scope of pre-closing exchanges of information, coordination and integration activities are relevant to antitrust authorities, especially in the case of merging parties who are competitors, given they may engage in conduct that impacts competition in the market.

During the interim period, it is usual for the parties to agree on performance of certain activities geared to completing the transaction. Along this line, it is commonly accepted in the context of corporate acquisitions for the parties to share information for due diligence purposes and to plan the integration process. Moreover, the parties may prepare to carry out some integration activities in non-competitively sensitive areas, such as systems integration, etc. Such activities and other interim convents to operate the business in ordinary course, will not be considered gun-jumping as long as they do not imply effective control over the target by the buyer.

The parties will be in violation of antitrust rules if, during the interim period, they share competitively sensitive information regarding prices, costs or volumes until closing. They will likewise be in violation if they enter into or otherwise reach price agreements for supply of products, agreements for production or supply of products, or for allocating clients or markets for the production or supply of products. There are no local precedents on this matter.

These behaviours by the parties prior to closing may be in violation of general antitrust prohibitions set forth in Section 2 of Uruguayan Law 18,159, which generally prohibits anticompetitive behaviour, and Section 4 BIS of that law, which prohibits hardcore cartels under a per se standard.

In Uruguay, there are no precedents of antitrust enforcement regarding anti-competitive exchanges of information in the context of M&A transactions. However, in other jurisdictions, including the United States and Brazil, there is frequent enforcement of gun-jumping and similar rules, which, in extreme cases, may delay or even preclude closing of an M&A transaction.

Efforts covenants

Efforts covenants are typical in cases of deferred closings subject to obtaining approval by third parties, such as authorisation by government agencies in regulated industries and antitrust authorities.

Given that approval depends on a third party alien to the contract, the party seeking the approval agrees to use its 'best efforts', 'commercially reasonable efforts' or other standard to secure such approval. From a civil law perspective, such clauses involve an obligation of means and not of results, and are likely to be construed to require a higher standard than ordinary diligence. In Uruguayan law, as is the case in other civil law jurisdictions in Latin America, there are no legal provisions or case law that could clarify the scope of this clause and its implications for the party assuming an obligation under same. In common law jurisdictions, like the United States, there is plenty of case law that informs the limits of each of these standards. Such case law has often been used as background to analyse the intended scope of such terms.

Depending on the requirements demanded by the regulatory authorisation process that is the subject of this clause, agreements tend to specify – and it is advisable that they do so – which party will be responsible for filing, the extent of cooperation required by each party, who pays any filing costs, and the consequences or impact on the transaction if the authorisation is not granted or if obtaining the authorisation goes beyond the deadline date set by the parties.

Given that antitrust rules requiring prior clearance by the Antitrust Authority are relatively new in Uruguay, it has not been usual to include 'hell-or-high-water' provisions in purchase agreements, requiring that the buyer takes all the risk of a negative antitrust decision in the transaction. The common practice in Uruguay is that the parties agree to make the antitrust filing jointly (as it requires input from both buyer and seller) and agree to use their respective best efforts to obtain the authorisation by diligently responding to information requests from the authority. Perhaps because the merger control regime is so new, it has not been typical that any of the parties commits to unconditionally accepting any material conditions imposed by the Uruguayan Antitrust Authority or by any other authority in order to close the transaction. Rather, if the Uruguayan Antitrust Authority imposes any material conditions, such situation has generally been included in the purchase agreement as one of the cases in which one or both parties (depending on the condition imposed) have the right to walk away from the transaction. The practice in agreements governed by the laws of a common law jurisdiction is very specific and nuanced and has been developed through many years of case law. This may, in the future, inform the drafting of agreements relating to Uruguayan targets. 'Materiality' in this case is often left as an undefined concept in the purchase agreement, although it could be possible to negotiate monetary thresholds or other parameters to determine materiality.

Pre-closing covenants

Pre-closing covenants are a key element in M&A transactions with deferred closings. They are basically commitments to do something (affirmative covenants) or to refrain from doing something (negative covenants) that, for the most part, fall upon the seller or target, although there are also transactions where the purchaser agrees to pre-closing covenants, such as obtaining approval by government agencies in the case of regulated industries, or securing financing to fund the purchase price and in cases where equity of buyer is being used as consideration or the transaction is structured as a merger of equals.

Covenants typically made by the target are intended to protect the purchaser so that it can acquire the business at closing in conditions substantially similar to those existing when the agreement was signed and that were evaluated by the purchaser in a due diligence process. Negotiation of pre-closing covenants can take significant time and effort, insofar as it is vital for the purchaser to ensure that during this period there will not be material changes in the business, and for the seller to retain as much flexibility as possible in operating its business pre-closing. Also, the condition of the business upon closing may be determinative of purchaser's liability to obtain financing (see Chapter 10 of this guide on acquisition financing).

These covenants come in many 'flavours' and they depend, among other things, on the particularities of the company and the industry in which it belongs to. It is common to include a covenant of the seller requiring it to maintain operation of the business in its ordinary course and in a manner consistent with the target's past practice until the acquisition takes place or the contract terminates pursuant to the terms of the purchase agreement. Common exceptions to this covenant are the performance of specific actions required to comply with conditions to closing (i.e., termination of agreements with related parties) and actions required by law or judicial or government orders.

In addition to the general obligation to operate the business in the ordinary course, purchase agreements usually include covenants that establish acts that the seller must in all cases refrain from performing during the interim period, except only with the purchaser's written consent, including, among others, the following:

- discontinue lines of business or other strategic changes at the level of the business plan;
- settle legal actions having a material impact on the business or exceeding a certain monetary threshold;
- Commit Capex;
- incur significant additional indebtedness; and
- increase salaries of personnel beyond legally mandatory adjustments.

Also, it is not uncommon to include a covenant whereby the seller agrees not to solicit, provide information to, or negotiate an alternative sale transaction with a third party other than the buyer ('no shop' clause).

Covenants are also negotiated to establish affirmative obligations for the seller. A frequent covenant requires the seller to keep the purchaser informed and to give it access to information allowing it to continue auditing the company and its course of business during the interim period between signing and closing. The scope of such a covenant tends to be heavily negotiated by the seller to prevent such access from interfering in practice in the operation of the business, or potentially from being challenged by a regulator in cases of regulated entities.

Covenants on public announcements are also commonly stipulated in purchase agreements. The parties mutually agree in advance upon the timing and content of any public announcement of the transaction to the financial sector, any authority, employees or the general public. An usual exception is when such announcement is required by applicable laws or regulations, for example, when the transaction has to be communication within certain period to the authorities or the stock exchange.

Closing conditions

The closing of a transaction can be simultaneous with signature of the purchase agreement or take place after an agreed period of time, once certain conditions defined by the parties have been met. Both sellers and purchasers are interested in the potential impact that these conditions can have on certainty of the closing.

The conditions for closing a deal depend largely on the particularities of the transaction. Nonetheless, the following clauses establishing the following conditions are usual:

- For the benefit of both parties:
  - All authorisations and consents by government authorities and stockholders that were necessary for moving ahead to closing have been obtained.
  - There are no legal impediments affecting the parties or precluding their ability to move ahead with closing.
  - The representations and warranties the other party made at the date of signing of the agreement remain unchanged at the closing date. This can be achieved subject to a standard of materiality by establishing that the representations and warranties the party made at the time of signature are correct and true in all material aspects (changes of scant relevance do not have an impact). It is usual for the purchaser to require certain fundamental representations to be correct and true in all aspects, such as representations on good standing of the seller and the target, ownership of the transferred interests, and, increasingly, representations on corruption, sanctions and money laundering.
  - Compliance with pre-closing covenants by the other party, including deliverables at closing, such as ancillary agreements (transition services agreement, employee matters agreement, tax matters agreement, etc.), certificates of good standing of the parties, evidence of obtaining the consents and approvals of third parties and government authorities, endorsement and delivery of share certificates, resignations of members of the board of directors at the closing date, etc.
- For the benefit of buyers:
  - Absence of a material adverse change.
  - Key customer consents or landlord consents that are relevant for the operation have been obtained.
  - The planned financing was obtained.[2]
  - Certain agreements may include specific conditions tied to the specific issues of the business discussed while negotiating price or resulting from findings in due diligence.

2 This has become a less typical provision in the region. See Chapter 10 of this guide on acquisition financing.

Update of disclosure schedules

The seller's representations and warranties, and the disclosure schedules related to those, are relevant to the scope of the seller's liability and the indemnity clauses. Non-compliance by the seller of a representation and warranty often triggers the seller's obligation to indemnify the purchaser per the terms set forth in the agreement.

Representations and warranties are statements of facts made by the seller regarding the seller, the transferred business and the target and usually cover a variety of issues, including relevant corporate aspects such as proper organisation of the entity and ownership of the shares to be transferred, as well as operational matters like those related to workforce, intellectual property, regulatory compliance, tax, financial aspects, etc. The disclosure schedules are key in determining the true scope of the representations and warranties of the seller and a usual element in purchase agreements.

In affirmative disclosures schedules, the seller discloses information that is required in the relevant representation and warranty. For example, often purchase agreements include representations and warranties that require the seller to identify certain information in the disclosure schedules that will inform the scope of the relevant representation and warranty. Examples include:

- lists of stockholders and any subsidiaries;
- employees and employee benefit plans;
- intellectual property that is registered by the target;
- government permits, approvals or authorisations that may be necessary depending on the type of activity, etc;
- insurance policies;
- real properties either owned or leased;
- litigation or legal actions; and
- material contracts.

In turn, what are known as negative disclosures are exceptions or limitations to what is represented by the seller, thus excluding such items from the relevant representations and warranties. For example, a seller can state in the representations and warranties that the target company does not have any contracts with change of control clauses except as established in the corresponding disclosure schedule. The risk assumption with respect of the disclosed matters shifts from seller to buyer.

During the interim period between signing and closing the target company in the transaction will continue its operations, executing new contracts with clients and suppliers, hiring or terminating relationships with employees or contractors, dealing with legal issues that may arise, etc. Considering the foregoing, an aspect that is usually negotiated by the parties is the possibility for the seller to update the disclosure schedules and the effects this may have on closing certainty and post-closing indemnification.

Depending on the case and on the negotiations, there are situations where updating is permitted and others where it is not. In cases where updating of disclosure schedules is permitted, such updates for the most part refer to matters that may occur between signing of the agreement and closing of the deal (to reflect post-signing information). Less common, because they are more resisted by purchasers, are updates whereby the seller discloses facts, issues or events that existed prior to signing and that should have been included by seller in the initial schedules delivered with the agreement.

These are contract areas that can give rise to tension between the parties and their respective interests, and pose a challenge for negotiators to achieve reasonable creative results depending of the circumstances of the transaction.

It is common in purchase agreements to include an obligation of the parties to deliver at closing a bring down certificate under which they represent and warrant that all the representations and warranties made in the purchase agreement are true and correct as of closing, and such bring-down of the representations is usually a closing condition. Parties often discuss whether seller is allowed to update the disclosure schedules prior to closing and how such updates may impact buyer's right to walk away from closing or to claim indemnity after closing. To prevent minor or insignificant inaccuracies of the representations and warranties to prevent closing, the seller may try to include a materiality standard so that only material changes allow for the termination of the purchase agreement. In the event of any breach or inaccuracy below such standard, closing will occur, and the buyer may have an indemnity claim against the seller for a breach of the representations and warranties. When updates to the disclosure schedule are allowed and the seller discloses a change and the buyer chooses to proceed with closing anyway, it is usually agreed that such disclosure will not limit the seller's liability with respect to the representations and warranties made at signing, although the parties can negotiate a specific solution for such situation at closing.

Termination rights

When there is a period of time between the signing of the purchase agreement and the closing of the transaction, the parties have to agree on the situations that shall give rise to the termination of the agreement. If any of those situations occur and one of the parties exercises its termination right, closing will naturally not take place.

The most used termination triggers in purchase agreements are the receipt of a notice sent by the authorities enjoining or otherwise prohibiting the transaction. Sometimes, the occurrence of a material adverse effect or the breach by any of the parties of their material obligations under the purchase agreement (often including a cure period for such breaches) is also an automatic termination event. Some of these conditions may be waived by a party. Sometimes specific obligations of the purchase agreement are listed so that only the breach of such obligations are grounds for termination.

It is also frequent to include that the purchase agreement can be terminated if closing does not take place before a certain date (often referred to as the 'outside date' or the 'drop-dead date'). However, this right to terminate is typically drafted such that it is not available to the party whose failure to fulfil its obligations or the conditions has been the cause of the failure of the closing to occur.

Breakup or termination fees can be agreed upon in the purchase agreement in connection with lack of regulatory approvals or financing commitments. That practice is fairly typical in New York law governed agreements and in other jurisdictions in Latin America, especially where antitrust enforcement has a strong history, but are not typically included in Uruguay.

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Indemnity Escrows and Other Payment Guarantees

Luis Burgueño, Alberto Córdoba, Marisol Márquez and Elías Jalife[1]

Type of indemnity or payment guarantees

Indemnification is a contractual remedy and risk allocation mechanism typically used in M&A transactions to compensate a party for damages[2] suffered as a result of misrepresentations and breaches of warranties and covenants that become known or materialise after closing with respect to pre-closing facts, events and circumstances.[3] Indemnification provisions are usually heavily negotiated by the parties, on the one hand, allocating the risk related to the transaction and providing certainty as to which party will be liable for such post-closing issues and, on the other, setting forth the terms, conditions and procedures under which the parties may seek such indemnification under the applicable transaction agreement.

In a traditional M&A transaction, the buyer as the likely indemnified party will negotiate for broad indemnification rights, while the seller as the likely indemnifying party will seek

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2 The type of damages that are susceptible of being indemnified is highly negotiated in M&A agreements. One point of frequent debate, with varying degrees and nuance depending on the applicable law of the agreement, is the inclusion or exclusion of indirect or consequential damages, '*lucro cesante*' or lost profits and opportunity costs, among others. Often, damages also include any claims and attorneys' fees. Throughout this article, we will refer to 'damages' including damages (*daños*) and losses (*perjuicios*), which under Mexican law are any loss or detriment suffered in the patrimony as a result of the breach of an obligation, and the deprivation of any legal gain, which should have been obtained with the fulfilment of an obligation, respectively.

3 Parties to an M&A transaction may agree on including other 'special' indemnification items, as well as protection against certain types of damages that otherwise may not be protected, such as attorneys' fees.

to limit the scope, term and amount of its indemnification obligations and may also try to limit the circumstances in which the indemnitee may bring a claim.[4]

A core aspect of indemnification provisions that requires significant negotiation from the parties is how the indemnity will be funded and payment thereof will be guaranteed. In practice, the mechanisms typically used for funding and securing an indemnity are the execution of an escrow agreement, set-offs against future payments, particularly earn-out payments, and a partial holdback of the purchase price.

Notwithstanding the foregoing, all personal and in rem guarantees legally available may be used as indemnification or payment guarantees in M&A transactions. The choice on the payment guarantees will often depend on various factors, including the specific characteristics of the transaction, the governing law, the purchase price of the transaction relative to the contingencies identified during due diligence, the ongoing and future relationship between seller and purchaser, etc. The agreed-upon indemnification provisions and the choice of the indemnity payment guarantees come down to the creditworthiness, credibility and payment capacity from the indemnifying parties.

In the following pages, we will focus on describing the indemnification or payment guarantees more often used and available in M&A practice.

Escrow and hold-back

In M&A transactions, the indemnified party, typically the buyer, will often seek to secure payment of indemnification obligations of the indemnifying party, typically the seller, by setting aside or holding back an amount of cash (typically calculated as a percentage of the purchase price) until the expiration of the survival term of the indemnification obligations, thereby securing liquidity for any payment due. In cases where there are multiple sellers that are jointly and severally liable to buyer for indemnity and other post-closing obligations, the sellers may also prefer to set aside necessary funds in escrow, to reduce the risk of being held accountable for the inability of another seller to fulfil its obligations.

The main difference between an escrow and a holdback is that, in an escrow, the portion of the purchase price set aside is held by a third party (typically an escrow agent but it can also be a trustee or a financial depositary), while in a holdback the buyer or indemnified party directly retains or holds that portion of the purchase price. Naturally, the buyer or indemnified party will prefer a true holdback of the purchase price as it allows it to retain control of the funds, while the seller or indemnifying party will usually prefer the retained amount to be held by a third party, as this mechanism reduces the amount of control the indemnified party has over the funds and increases the likelihood that any funds remaining after payment of indemnification claims and expiration of the relevant term will be promptly released to the indemnifying party.

4 Limitations on the circumstances under which an indemnitee may bring a claim include monetary thresholds such as *de minimis* amounts, baskets and caps, as well as 'anti-sandbagging' provisions, which generally seek to prevent a party from bringing an indemnification claim for breaches of representations and warranties of which such party had actual or constructive knowledge prior to closing.

When agreeing on an escrow or holdback, parties should consider that the indemnifying party will often seek for such mechanism to be the only post-closing remedy for any indemnification claims and will try to limit the liability to the amount of the holdback or escrow amount, subject to customary exceptions, such as indemnity with respect to breach of fundamental representations or non-waivable rights in the case of fraud. In M&A practice, holdbacks are used far less often than escrows.

Furthermore, depending on the characteristics of the transaction, the parties may explore the possibility of maintaining a single holdback or escrow or separate holdbacks or escrows to secure payment of their indemnification obligations.

Escrow

In essence, an escrow is a segregated account that the parties to an M&A transaction often use for securing payment of their indemnification obligations, where the funds deposited in the account are held by a third party, whether an escrow agent, a trustee or a depositary. An indemnification escrow is typically funded by setting aside and depositing a portion of the cash payable as purchase price with a third party (whether into an escrow account, a trust or a security deposit).

Escrows are usually set forth as a contractual remedy in the main transaction agreements, securing payment of the parties' indemnification obligations, but also must be documented and effected in a separate agreement (ancillary to the acquisition agreement), such as an escrow agreement, a trust agreement or a security deposit agreement, as agreed upon by the parties, which will include the third party's rights and obligations in connection with its role of custodian of the funds. The choice of legal figure through which an escrow will be implemented in a given M&A transaction shall depend on several factors, such as the governing law, the domestic or cross-border nature of the transaction and the parties, the leverage one of the parties may have on the other.

While not prohibited by Mexican law, as is the case in most Latin American jurisdictions, escrow agreements are not regulated and thus, when the transaction is subject to Mexican law, the escrow is usually implemented through the execution of a trust agreement or a security deposit.

Escrow agreement

An escrow agreement is the typical form of implementing an escrow in M&A transactions and such legal figure is not provided or regulated as such under Mexican law and other jurisdictions in Latin America, although there are other legal figures with substantially similar effects, as we will further describe.

The parties to an M&A transaction may agree on the execution of an escrow agreement governed by US law and subject to a forum in the United States, when either the transaction documents are governed by US law and subject to a forum in the United States or one of the parties pushing for US law and forum for the escrow agreement has enough leverage. In this regard, it is very likely that the escrow agent will require that the governing law and forum of the escrow agreement be the one of the jurisdiction in which the escrow agent is located, even if that governing law is different from the other transaction documents.

The escrow agreement with the escrow agent sets out the terms and conditions under which the escrow agent will hold and release the escrowed funds, in exchange for a fee. Escrow agents are usually banks or other financial institutions that often have their own standard forms of escrow agreements under which they provide their services and that set forth standard terms and conditions for such type of transactions. Although escrow agents are often open to negotiate their forms to accommodate some of the terms and conditions agreed by the parties, it is advisable to involve the escrow agent early on in the process to make sure that the terms negotiated by the parties are agreeable to the escrow agent.

Among the main terms and conditions of the escrow agreement often negotiated with the escrow agent are those regarding the distribution of funds or payments arising from indemnification claims and the rules applicable to the investment of escrowed funds. The parties will want to ensure that the escrow agent has a clear set of rules for the distribution of funds and the escrow agent will want to be released from any liability that may arise therefrom, for which the escrow agent will generally require either a joint written instruction by the parties, or a final decision of a court, arbitral panel, or other third party with authority over the underlying issue, prior to releasing any funds in the escrow. For such purposes, the parties shall agree on the applicable instructions, notices and other procedural rules for the release of funds, including upon expiration of the escrow period.

Additionally, the parties often have to consider if there will be a single or separate escrow accounts covering different risks. The latter may be used when there are various specified identified material, guaranteed obligations or when the escrow will also cover post-closing adjustments agreed under the transaction agreement. The indemnified party will often prefer one account to have more funds available to collect the applicable claims against the indemnifying party, regardless of the underlying indemnification event, while the indemnifying party will usually prefer separate escrow accounts to isolate exposure of the amount in escrow and provide for separate escrow release dates. These considerations by the parties may also arise depending on the agreement of different release dates of the applicable indemnification obligations or other obligations guaranteed by the escrowed funds.

In transactions where the purchase price is represented by stock or a note, it is not uncommon for the parties to place such stock or notes in escrow to guarantee their indemnification obligations. In these cases, aside from the fact that the parties shall pay particular attention to the applicable securities and tax provisions, they should also have to agree and set forth the terms and conditions applicable for the valuation and transfer of such stock held in escrow upon an indemnity claim.

Selecting the escrow agent

When choosing the escrow agent or a trustee or depositary, the parties might consider whether any of them has an existing or strong relationship with such agent to address potential conflicts of interest but also so that they are in a position to negotiate better fees and terms under the escrow agreement (or the applicable guarantee trust or security deposit agreements). Both parties look for a reliable independent party so that it will not be prejudiced towards or against any of them in following the agreed upon rules and procedures, especially regarding release of funds to any of them.

It is advisable that the parties identify who the escrow agent will as soon as possible be able to negotiate the escrow agreement in good time, as well as to agree on the way the agent's fees will be paid between the parties. Although the parties may negotiate the payment of the escrow agent's fees, it is very common for the escrow agent's fees to be split between the indemnifying party or seller and the indemnified party or buyer. Furthermore, it will give the parties time to determine the rules applicable to the investment of the funds in escrow (or guarantee trust or security deposit).

Escrow amount and term

In M&A transactions, when determining the amount of the escrow (or amount transferred into a guarantee trust or security deposit), the indemnified party will usually try to ensure that the amount is high enough to cover all possible indemnity claims and that the term is equal to the survival period for non-fundamental representations and warranties agreed upon in the transaction agreement, which typically may range from six months to as long as three years (most commonly between 12 and 18 months).

The indemnified party may also take into consideration the effort that may be required to bring an indemnity claim and collect payment thereof, as well as the creditworthiness of the indemnifying party. On the other hand, the indemnifying parties will try to keep the escrow amount and period as small and short as possible.

In M&A transactions, it is common practice for the escrow amount to be agreed upon as a percentage of the transaction value or purchase price; however, this percentage may significantly vary between transactions, typically around 7 to 20 per cent depending on the nature and size of the deal, the depth and results of due diligence. Escrow amounts lower than 10 per cent of the purchase price are typically limited to larger deals or in cases where the escrow is not the exclusive remedy available to the indemnified party or buyer, as other guarantees or insurance may be in place to guarantee payment of indemnity claims or other obligations of the parties under the transaction agreement.

It is also common practice to structure the escrow in tranches that guarantee specific indemnification obligations for contingencies identified during due diligence (for instance, tax claims or pending litigation), with their own set of term and release dates.

Interest accrual beneficiary

In M&A transactions, the determination of which party, whether the indemnified or the indemnifying party, is entitled to receive the accrued interests generated by an indemnity guaranteed amount, if any, is especially important in guarantees in which the guaranteed amount is transferred to another entity and administrated somehow that it generates an interest, as is the case of an escrow, a guarantee trust or a security deposit.

In a holdback whereby the buyer or indemnified party retains a portion of the purchase price, although it may be negotiated otherwise, typically the buyer is required to hold the funds in a separate account and any accrued interest will be for the benefit of the indemnifying party.

When the payment guarantee is being held in escrow, the indemnifying party is typically the one entitled to receive the accrued interests generated by the guaranteed amount. However, the parties often negotiate whether accrued interest should be distributed to the indemnifying party or should be part of the escrowed funds that may be used to secure the covered obligations. The parties may also agree for the escrow agent to carry out investments under a specific set of rules. Although there is no rule of thumb, the indemnified party is usually more concerned than the indemnifying party with maintaining very conservative investment guidelines, providing for liquid investments that make it easy for the escrowed funds to be available as needed.

Release notices and conditions

In M&A transactions, release of the indemnification payment guarantees are typically subject or linked to the survival term of the indemnification obligations. The general rule is that both the payment guarantees and the indemnification obligations of the parties are released and expire, respectively, by the sole course of time. However, the escrow terms and conditions typically provide for the extension of the release term if an indemnification claim is filed before the expiration of the release term, for the indemnified party to bring its claim to court or arbitration and, once started, until the dispute is settled.

In any case, it is advisable for the parties to an M&A transaction to agree on clear release mechanisms of the escrowed funds. These mechanisms include setting forth the procedure applicable to indemnity claims, including notices from the indemnified party to the indemnifying party upon the occurrence of any misrepresentation or breach of warranty or covenant from the indemnifying party, periods for the indemnifying party to cure any misrepresentation or breach of warranty or covenant, as well as the resolution mechanism applicable in the event of controversy on an indemnity claim (arbitration is typically used in M&A deals in Latin America).

Also, it is key to agree on clear and unequivocal release conditions or triggers. These release conditions or triggers may consist of notices to the applicable agent, which may be agreed to be given jointly by the parties upon settlement of an indemnification claim, or even from a third party such as third-party law firm confirming that the applicable conditions for releasing the funds have been met, or if a party provides a final and non-appealable judgment by competent court or tribunal requiring payment of the relevant sum to the indemnified party. Escrow agents typically prefer joint written instructions by the parties, as they do not want to be caught up in disputes among the parties (e.g., in connection with the calculation of interest payable in accordance with a court order).

Additionally to the agreed release conditions, the parties may consider different or staggered release dates of the escrowed funds, which are typically preferred and negotiated by the indemnifying party or seller, while the indemnified party or buyer will prefer to maintain the escrowed funds for the longest possible period of time. This is more often agreed when the agreed upon escrow term or amount is high compared to market standards, when other obligations or adjustments are covered by the escrowed funds or when the indemnification obligations have different survival terms, in which case a portion of the escrowed amount may be released following the applicable adjustments or calculations, and the remaining amount may be released after the expiration of the applicable indemnification term.

Guarantee trust

When the parties to an M&A transaction agree on securing their indemnification obligations under Mexican law, an often used vehicle is a guarantee trust. Under a guarantee trust agreement, the indemnifying party transfers an amount of money (typically a portion of the purchase price) to a trustee, which maintains legal title to such funds and provides its services in exchange of certain fees, until the expiration of the survival term of the relevant party's indemnification obligations under the transaction agreements.

Under Mexican law, only financial institutions such as banks and other authorised legal entities such as SOFOMs (multiple-purpose financial companies) are authorised to act as trustees in guarantee trusts. Applicable laws and regulations provide specific rules applicable to such form of trust and trustees typically have their own standard forms of guarantee trust agreements under which they provide their services and which set forth standard terms and conditions for such type of transactions.

Similar to those provisions available under escrow agreements, under a guarantee trust, the parties may agree on specific rules for distribution of funds or payments arising from indemnification claims, the establishment of the amount of the guarantee trust and the authorised investments of the transferred funds.

Security deposit

Another legally available mechanism commonly used in Mexico to secure payment of indemnification obligations in M&A transactions is a security deposit. A security deposit is an agreement under which the indemnifying party transfers possession of funds (again, typically a portion of the purchase price) to a third party depositary. Under a security deposit agreement, the depositary acts solely as such (unlike the trustee which is transferred the legal title over the funds) and has the obligation to maintain such funds and any proceeds or interests accrued therefrom

Depositaries are usually financial institutions authorised as such under Mexican laws and regulations and provide their services in exchange of a fee. As in the escrow and guarantee trust agreements, the depositaries often have standard security deposit agreements under which they provide their services and which set forth standard terms and conditions for such type of transactions. However, the parties may negotiate certain terms and conditions to abide to the provisions of the transaction agreements.

It is worth mentioning that, depending on the nature of a particular transaction, choosing one of the previously mentioned mechanisms instead of another becomes relevant. The parties have to take several matters into consideration, such as the applicable fees for each mechanism (guarantee trust or security deposit) and even the particular regulation that would apply in the absence of a specific agreement on a particular subject.

Holdback and set-off rights

As mentioned above, parties to M&A transactions, and specifically the buyer, may seek to secure payment of their counterparty's indemnification obligations by holding back a portion of the purchase price until the expiration of the survival term of the indemnifying party's indemnification obligations.

On the other hand, when an M&A transaction provides for one or more post-closing payments that are contingent on the satisfaction of certain milestones related to future performance, the indemnified party may seek to secure payment of the indemnifying party's indemnification obligations by including a set-off covenant in the applicable transaction agreement.

Holdback of the price by the purchasing party

If a holdback of a portion of the purchase price by the purchasing party is agreed as guarantee of the indemnifying party's indemnification obligations, the indemnified party will directly hold or retain that amount until the expiration of the survival term of the indemnification obligations or shorter period agreed upon. If, upon expiration of the applicable term, no indemnity claim and payments are due or pending, the indemnified party is required to deliver the holdback amount to the seller or target.

Holdbacks are not commonly used as guarantee payments as they give full control of the holdback amount to the indemnified party. Thus, holdbacks are agreed upon when the buyer or indemnified party has substantial leverage over the seller or indemnifying party or when there is a broader long-term business relationship between the parties to the transaction. The foregoing, as usually the seller or indemnifying party will prefer that the funds are held by an independent third party.

Additionally, the parties may agree that a holdback covers both working capital adjustments or other price adjustments and indemnification claims. Under this scenario, it is common to agree the release of a portion of the holdback amount following the final working capital calculation or price adjustments, and the remaining holdback amount to be released after the expiration of the indemnification survival term.

Set-off right against earn-out and other future payments

If the purchase price of an M&A transaction includes certain future or milestone payments or earn-out payments, usually to be paid to the selling or indemnifying party, the parties to such transaction may consider using a set-off mechanism for securing and funding indemnification obligations. Under this mechanism, the parties may agree on certain provisions in the transaction agreement for the purchasing party to withhold the pending milestones or earn-out payments to which the seller or indemnifying party is entitled to as guarantee payment of its indemnification obligations if indemnity claims and payments derived therefrom arise and are due to the indemnified party after the closing of the transaction.

Strictly speaking, a set-off is the reduction of future payments in the amount owed to the indemnified party under the indemnifying party's indemnification obligations. This mechanism may be a good incentive for the indemnifying party to achieve the intended performance; however, the downside is precisely the fact that such future payments are often conditional or uncertain to occur. If the target company fails to meet the specified milestones within the agreed periods, the buyer will be released from paying the applicable payment or earn-out to the seller.

Under this mechanism, the buyer or indemnified party will seek to have the right to withhold and offset contingent payments that have materialised for the benefit of the seller, against amounts owed by the seller to the buyer in connection with indemnification claims. In the end, the agreed-upon provision will often depend on the leverage the indemnified party may have over the indemnifying party. Usually, the parties agree on the specific provisions applicable for exercising a withholding and offset right, such as the requirements applicable thereto, notices and dispute resolution mechanisms between the parties. When the parties do not agree on the applicable mechanisms for exercising and settling disputes on these matters, it may be more complicated in practice as they would have to raise such claims before the competent courts and payment derived therefrom may only be collected upon a final and non-appealable judgment.

Other in rem guarantees

There are cases in which the parties' indemnification obligations can be secured by assets different from cash, often related but not within the scope of the transaction. The buyer will seek that the assets used to secure such indemnity payments are of greater value (whether collectively or individually) than the estimate amount of the indemnification amount agreed by the parties. Assets that have an active trading market (such as equity of publicly traded companies) are also preferable. Assets that may provide immediate liquidity like real estate or privately held shares with dividend rights are also appealing. Assets used as guarantee can be owned by the indemnifying party or by a third party (usually related to the indemnifying party). However, involving a third party will necessarily increase the complexity of the negotiations and the execution.

In the event of an indemnity claim, the indemnified party would be entitled to receive payment thereof whether by acquiring title to the collateral or by the amount derived from the execution and sale of such assets, as agreed by the parties.

There are two main types of in rem guarantees, depending on whether the collateral is real estate or personal property, available to parties to an M&A transaction for securing their indemnification obligations. These guarantees are typically required to be granted before notary public and registered before public registries to be valid and perfected, that is, enforceable on third parties.

Mortgage

Security interests over real estate may include mortgages. In that case, the indemnifying party grants a security interest over real estate that is out of the scope of the transaction (i.e., not owned by the target nor sold in an asset deal). Mortgages are seldom used to secure indemnification obligations but can be useful where the purpose of the transaction is liquidity and there are real estate assets related to or carved out of the transaction that can be mortgaged. When the seller or the indemnifying party may not have the liquidity to guarantee its indemnification obligations with cash or other goods, the buyer or indemnified party may agree on having its indemnification rights guaranteed by this type of security interest. The liquidity provided by a guarantee over a specified asset other than cash will be dependent on the marketability, value condition and other specific facts of the relevant asset upon possession or foreclosure.

The real estate typically used as security through a mortgage is related or carved out of the scope of the transaction, such as the real estate where a certain facility is located that is owned separately by the selling shareholders rather than by the target company (a common arrangement in privately held companies). That real estate is often leased post-closing to the target company and thus is of particular value to the purchaser.

This guarantee mechanism in Mexico, as is the case in most civil law jurisdictions in Latin America, is perfected through the execution of a mortgage agreement before a notary public and further registered before the public registry of property of the place where the real estate is located. As a result of the mortgage, the indemnified party will have an in rem right to enforce the mortgage in the event of the indemnifying party's failure to comply with its payment indemnification obligations.

Pledge over stock or other personal property

Parties to an M&A transaction may opt for securing their indemnification obligations through a pledge, that is, an in rem guarantee over other personal property, typically related to or carved out of to the transaction.

In general, any personal property can serve as collateral in an indemnity payment guarantee; however, the most common type of pledges are those granted over the indemnifying party's remaining stock in the target company. Pledges over stock are often used when the buyer acquires a controlling interest in the target company and, therefore, the selling party maintains a minority interest in the company.

Pledges of stock are relatively easy to implement in Mexico as in most Latin American jurisdictions, as they are perfected through execution of a pledge agreement, endorsement and delivery of stock certificates and registration in the stockholders' ledger book. No notarisation or registration is required for perfection in Mexico.

Less commonly, the parties to a transaction may agree to secure their indemnification payment obligations with other personal property out of the scope of the transaction (i.e., if the transaction includes the acquisition of the shareholding interest of the target company but not of certain of its assets and the parties agree on a lease thereof, such as equipment, the indemnifying party may guarantee its payment obligations with such assets not subject to the transaction but related to the business).

Personal guarantees

Parties to an M&A transaction may agree that their payment indemnification obligations are guaranteed by a third party, which may or not be related to the parties to the transaction. In these type of guarantees, the person or entity that issues the guarantee undertakes the indemnifying party's payment obligation either directly or in case of default by the indemnifying party, and, as a result thereof, the indemnified party has a direct action against the third party granting the guarantee to collect payment derived from an indemnity claim.

Below we describe the most common forms of personal guarantees used in M&A transactions to guarantee the parties' payment indemnification obligations.

Parent guarantees and other personal guarantees granted by related parties

In practice, guarantees granted by related parties to an M&A transaction are usually an alternative when the seller is a holding or special purpose vehicle or is otherwise not an operating company with sufficient creditworthiness and thus the parent company or another affiliate has to guarantee the seller's obligations. In contrast, such guarantees are typically not required when the indemnifying parties are stand-alone companies or entities with a substantial balance sheet and operations of their own.

Parent guarantee

A parent guarantee is a payment guarantee granted by a parent or an affiliate company of the indemnifying party to secure any indemnity payment obligation of such indemnifying party. Parent guarantees are common in M&A practice and are often implemented through the inclusion of a specific guarantee clause in the transaction agreement or the execution of a separate surety agreement setting forth the guaranteed obligations, customary waivers to guarantor's legal protections, limitations of guarantor's liability and other terms and conditions of guarantor's obligations.

Depending on the terms and conditions set forth either in the specific guarantee clause included in the transaction agreement or in a separate surety agreement whereby the parent guarantee is granted, the indemnified party will be able to collect the indemnity directly from the parent guarantor or only upon the indemnifying party's default or delay.

Joint and several liability

A fairly used mechanism to secure payment of indemnification obligations in M&A transactions is the joint and several liability of multiple sellers or of a parent company or other affiliate. When there is more than one indemnifying party, it is common that all indemnifying parties guarantee all of their obligations under the transaction agreement, including their indemnification obligations, as joint and several obligors.

Similarly to the parent guarantee, it is common for a parent or affiliate company of the indemnifying party to enter directly into the transaction agreement to act, typically, as a joint and several obligor of the indemnifying party regarding all its the obligations set forth in the agreement, including its indemnification obligations. If a joint and several obligation is undertaken, the indemnified party would be entitled to collect payment of any indemnity amounts from any of the indemnifying parties or its parent or affiliate company, as applicable.

Personal guarantees granted by third parties

Exceptionally, indemnification obligations may be guaranteed by third-party financial institutions, either through a standby letter of credit or a surety bond.

Standby letter of credit

A standby letter of credit is an instrument whereby a financial institution, acting upon the request and instructions of a client, irrevocably agrees to pay certain amount of money to a third party upon demand and delivery of certain documents. As the letter of credit constitutes a direct obligation of the financial institution, from the indemnified party's perspective the credit risk is shifted from the indemnifying party to the financial institution, and thus is very favourable to the indemnified party, though usually expensive.

In M&A transactions, the standby letter of credit can be a mechanism for securing the parties indemnification obligations, for which the indemnifying party shall obtain such standby letter of credit from a financial institution naming the indemnified party as beneficiary, and such indemnified party is entitled to obtain payment from any damages derived from an indemnification claim directly from the financial institution issuing the standby letter of credit. Standby letters of credit used in M&A transactions are commonly subject to rules issued by the International Chamber of Commerce, such as the ISP98 (International Standby Practices published in 1998) or the UCP 600 (Uniform Customs & Practice for Documentary Credits published in 2007).

This mechanism is often used in M&A transactions when the indemnifying party either (1) previously provides the applicable funds to the financial institution for the issuance of the standby letter of credit; or (2) has an existing line of credit with the financial institution and the standby letter of credit used to secure its indemnity obligations is the means to dispose of that credit. In both cases, the standby letter of credit is irrevocable.

The standby letter of credit may be convenient for the indemnified party as it is easily enforceable and the risk of insolvency of a financial institution is typically low, especially relative to the indemnifying party's; however, the letter of credit may entail a big financial burden to the indemnifying party as it will have to obtain (or use an existing) credit facility with the financial institution and in some cases grant collateral to secure its obligations before that institution and assume restrictive covenants during the term of the credit facility.

Surety bond

Another useful indemnity guarantee granted by a third party is the surety bond. In order to guarantee an indemnity payment through a surety bond, the indemnifying party has to contract with a surety institution, which agrees to pay such party's indemnity payment obligation in case the indemnifying party fails to do so.

The surety bond is typically implemented through the execution of a surety agreement or surety line. It is possible for the parties of a surety agreement to determine the scope of the surety bond; by default, the surety institution has order and excuse benefits in granting a surety bond. Therefore, due to the order benefit, the surety institution is liable before the indemnified party only if the indemnifying party has failed to make the respective payment. Likewise, the surety institution has the excuse benefit, through which it can appoint some or all the indemnifying party's assets to pay for the indemnity amount if such amount is requested to the surety institution by the indemnified party. Both the order and the excuse benefits can be, and in practice are normally, waived by the surety institution, which would be more convenient to the indemnified party, since it would have higher collection possibilities against the surety institution.

The surety institution collects a fee, typically calculated as a percentage of the contingent amount, in connection with the secured amount and has recourse against the indemnifying party if the institution has to pay some or all of the indemnity claim. In practice, the surety institution usually requires the indemnifying party to prove its solvency so that the surety institution can validate its creditworthiness. The surety institution may even require the contracting party to guarantee the payment of the secured obligations by some other means (for example, a mortgage).

Promissory note

Although not very commonly used, it is also useful for the parties of a transaction to secure the payment of their indemnity obligations through the execution and delivery of one or more promissory notes. The promissory note is a negotiable instrument that constitutes an unconditional promise of payment made by the indemnifying party should that indemnifying party be bound to pay any indemnity claim to the indemnified party. Promissory notes may be convenient because of their nature as negotiable instruments, which means that, in practice, they can be usually enforced in special judicial procedures that are often faster and give greater collection rights to the indemnified party than other mechanisms, such as the possibility of embargoing assets from the indemnifying party at the beginning of the judicial proceeding. However, a promissory note does not provide security over specified assets and therefore, it does not solve for potential lack of creditworthiness and insolvency of the indemnifying party.

Appendix 1

About the Authors

Jonathan Adler
Debevoise & Plimpton LLP

Jonathan Adler is a corporate partner based in the New York office and a member of the firm's Investment Management Group. His practice focuses on advising sponsors of private investment funds, including buyout, growth capital, energy, infrastructure and credit funds. In addition to his work with US and European funds, Adler has also advised clients in establishing private equity funds, offices and joint ventures in various emerging markets, including Africa, India and South America.

Adler is ranked as a leading lawyer for private equity funds by *Chambers Global* and *Chambers USA*, where clients describe him as 'a supremely talented fund formation lawyer providing thoughtful and commercial advice; he is very creative.' In previous editions of the guides, clients have noted that he has a 'fine combination of really good technical skills and a really good sense of the commercial and practical realities' and that he is 'an extraordinary lawyer; he's very thoughtful and brings a commercial, get-things-resolved attitude.' Adler was named in *Private Funds Management*'s 30 Under 40, which recognises the top private equity funds lawyers under the age of 40. He was also named a Rising Star by *IFLR1000* (2020).

Claudia Barrero
Philippi Prietocarrizosa Ferrero DU & Uría

Claudia Barrero is a partner at Philippi, Prietocarrizosa Ferrero DU & Uría in the Colombian office. Her legal practice focuses on corporate M&A and capital markets. She focuses on mergers and acquisitions of listed companies and has extensive experience in capital markets, infrastructure projects and corporate governance matters. She has acted as adviser to issuers on IPOs and debt issues, as well as to several Colombian and international clients in matters such as cross-border mergers and acquisitions and all related corporate governance aspects. She has also advised the Colombian government in various privatisation processes, especially in the energy sector.

Claudia was recognised by Euromoney Legal Media Group's Americas Women in Business Law Awards with the award for Best Corporate Lawyer of the Year in Latin America (2014) and was listed as one of the Inspiring Women in Law in Latin America, by *Latin Lawyer* (2013).

Luis Burgueño
Von Wobeser y Sierra

Luis Burgueño is a partner of, with more than 30 years of experience in M&A, corporate matters and transactions in general. He is a member of the executive committee of the firm and is co-leader of the Energy and Natural Resources Industry Practice Group.

His corporate practice is diverse, focusing on mergers and acquisitions and corporate and commercial transactions in general, including mergers, spin-offs, strategic alliances and IT transactions, both domestic and transnational, with emphasis on the consumer goods, energy and technology sectors.

His clients include public companies on the Dow Jones, S&P, DAX, Nikkei and BMV indexes, some of the most profitable Forbes 100 Top Brands, and some of the largest and most innovative private capital and risk capital funds. He has performed a key role in some of the most innovative and complex M&A matters and transactions taking place recently in Mexico and Latin America.

Nicolas Camacho
Credit Suisse

Nicolas Camacho is a managing director at Credit Suisse in the investment banking and capital markets division responsible for the M&A practice in Latin America. Based in New York, Nicolas has been with Credit Suisse since 2007 and has participated in over 100 M&A transactions in the region. Mr Camacho holds an MBA from Harvard Business School.

Giancarlo Carrazza
D'Empaire

Giancarlo Carrazza is an associate in D'Empaire's arbitration, corporate and M&A practice groups. His practice is focused on advising domestic and international clients on mergers and acquisitions and general corporate matters in a range of industries that include manufacturing, insurance and financial services. Giancarlo also has experience representing clients in domestic and international arbitrations, including commercial and investor-state disputes under the ICSID, UNCITRAL and ICC rules. He received a JD *summa cum laude* from Universidad Católica Andrés Bello in 2018.

Martín Cerruti

FERRERE

Martín Cerruti leads the FERRERE corporate and commercial and mergers and acquisitions groups. His experience and professional practice also cover agribusiness, infrastructure, mining, business companies and telecommunications.

For over 20 years with FERRERE, Cerruti has advised international corporations such as Abbott, BellSouth, British American Tobacco, Cummins, Dufry, ExxonMobil, Starbucks, Vale, Volt, Weyerhaeuser, and Yamaha in Uruguay. Over this time, he has represented their interests in large-scale investments and deals. He has also headed up teams in merger and acquisition processes, including for BellSouth, CNOOC, Vale and Weyerhaeuser, in coordination with clients' in-house counsel and with other international law firms.

In the years before joining FERRERE, Martín Cerruti was manager of Price Waterhouse's legal and tax department (1995–1997).

He has published articles on business law and been a speaker at seminars on information technologies in Brazil, Mexico and Paraguay. He was local representative for Uruguay at the International Technology Law Association. He has been a professor of Business Companies and Corporate Finance, as well as of Company Law in the undergraduate and graduate degree at Universidad ORT (Uruguay). He is currently a professor of Mergers & Acquisitions and Commercial Contracts at the University of Montevideo.

Alberto Córdoba

Von Wobeser y Sierra

Alberto Córdoba is a partner of Von Wobeser y Sierra, with more than 15 years of experience in M&A, corporate matters and transactions in various industries, including oil and gas, energy, the media, heavy and light manufacturing, retail and private capital. He is a member of the corporate and mergers and acquisitions practices and of the Energy Industry Group.

His practice focuses primarily on mergers and acquisitions and corporate matters. His experience includes, mergers, asset transfers, strategic alliances and joint ventures, both nation and transnational.

Within the mergers and acquisitions practice he regularly advises large national and multinational companies and global private capital investors in acquisitions and investments in multiple industries in Mexico.

In the energy sector his experience includes numerous transactions, both public and private, including projects launched by the productive companies of the State, Pemex and the Federal Electricity Commission.

Jaime Cubillos

Posse Herrera Ruiz

Jaime Cubillos is a partner at Posse Herrera Ruiz. His practice focuses on corporate transactions with a focus on domestic and cross-border mergers and acquisitions, representing acquirers and targets in cross-border acquisitions, auctions, dispositions and joint ventures.

Prior to joining the firm, Jaime worked for over five years in the New York offices of Skadden, Arps, Slate, Meagher & Flom LLP. During his time at Skadden, Jaime was highly active in cross-border M&A transactions in Latin America, including in several award-winning deals in the region. He also participated in several cross-border syndicated financing facilities and public and private offerings of debt securities in the international capital markets.

Jaime is admitted to practice in Colombia and the State of New York. He has a JD from Universidad de los Andes, and an LLM from Northwestern University School of Law. His native language is Spanish and he is fluent in English.

Vanessa Dager

Credit Suisse

Vanessa Dager is a managing director for Credit Suisse's M&A group within the investment banking and capital markets division and co-head of the sell-side group. Based in New York, she is responsible for the bank's dedicated M&A practice for sponsor and privately owned companies across the Americas. Vanessa is responsible for advising clients across industries in their strategic M&A transactions.

Prior to joining Credit Suisse, Vanessa served as a vice president within the Latin America coverage team for Citigroup Global Markets in New York. She also spent three years as an associate at Stern Stewart & Co.

Vanessa holds an MBA from the Wharton Business School of the University of Pennsylvania and a BS degree in Industrial Engineering from the University of Los Andes (Bogota, Colombia).

Iván Delgado González

Pérez-Llorca

Iván Delgado joined Pérez-Llorca in 1999 and was made partner in January 2007. He is the resident partner at Pérez-Llorca's New York office. In addition, he is responsible for the firm's US desk and LatAm desk.

Iván has more than 20 years' experience and specialises in mergers and acquisitions of listed and unlisted companies, venture capital operations and general corporate and commercial matters. He advises industrial groups such as funds on prominent cross-border transactions in diverse sectors. His focus on advising Latin American clients has provided him with the opportunity to be involved in some of the most significant transactions in the Spanish market. He has international experience working as a secondee in the London office of Slaughter and May.

Iván has extensive teaching experience. He was an associate professor of Corporate Law at Universidad Carlos III in Madrid and at the Instituto de Empresa (IE).

Santiago Fontana

FERRERE

Santiago Fontana is a partner of FERRERE's corporate and M&A practice. He focuses on foreign investment, mergers and acquisitions and general commercial and corporate matters. Santiago also worked in FERRERE's Bolivia office from 2005 to 2006 and has a strong connection to FERRERE's Brazilian and Asian clientele.

Santiago has participated in numerous high-profile foreign investment projects, as well as mergers and acquisitions. He participated in the set-up of the first services-exclusive free trade zone in Uruguay and more recently assisted several investors from Asia in landing their projects in Uruguay. Santiago was involved in the acquisition of the largest Uruguayan meatpacking plant by a Japanese food producer, as well as in the acquisition of three food processing plants and meat packing plants by Chinese investors.

Santiago also participated in high-profile deals such as the sales of the local operations of Outfront Media and Affinia International.

Santiago has extensive experience in government procurement processes and government-related work, both for private companies and government entities. He has also assisted international companies in their strategic and corporate matters, including Weyerhaeuser, Volt Information Sciences, IBM, Tyco, CBS Outdoor, Edenred, Lactalis, Parmalat, ExxonMobil, COSAN, Petrobras, Cisneros Group of Companies, DASA and Vale.

Peter A Furci

Debevoise & Plimpton LLP

Peter Furci is a broad-gauge tax lawyer who serves as co-chair of Debevoise's global tax practice. He specialises in M&A, investment fund formation and general corporate transactions and works closely with Debevoise's private equity, family enterprise, corporate M&A and Latin America groups.

Over the years, Furci has built a reputation as a creative and commercial problem-solver. He is listed as a leading tax lawyer by *Chambers Global* and *Chambers USA*, where clients have described him as 'extremely smart' and 'collaborative, creative and technically excellent', 'with a solid base of experience in deals and a good sense of market trends'. Clients have also noted that he 'consistently produces high-quality work and is very responsive' and that he is 'a phenomenal tax lawyer who is practical and solution-oriented'. Furci is recognised by *The Legal 500 US*, where sources have noted he is 'outstanding, proactive and thoughtful' and 'simply the best tax lawyer I have ever worked with'.

A frequent writer and speaker on tax and private equity, Furci is an adjunct professor of tax law at New York University Law School and serves on the executive committee of the New York State Bar Association tax section.

Manuel Galicia

Galicia Abogados

Manuel Galicia's practice focuses on domestic and international commercial transactions. He specialises in advising major corporations on finance, mergers and acquisitions and matters affecting corporate policy and strategy.

He has wide-ranging experience in operations focusing on credit facilities, private and public securities and debt offerings, co-investment, privatisation, mergers and acquisitions, and corporate restructuring, among others. He has counselled local, state and federal governments, as well as other government entities, in a variety of commercial transactions. He is on the board of directors for numerous companies. Clients look to him particularly for strategic counsel and tactical input on a wide variety of legal matters.

He was a legal consultant to the Coordinating Office of Foreign Trade Organizations during the negotiation of NAFTA and the free trade agreement with the European Union and has served as an adviser to national and international organisations.

He has international experience working as a foreign associate at Baker & Botts.

Manuel is rated in the top tiers of the most highly recommended M&A and private equity lawyers in Mexico by the leading directories. He has been recognised as a Tier-1 Lawyer and recently as 'Eminent Practitioner' in corporate law, mergers and acquisitions and in banking and finance by *Chambers and Partners*; a Tier-1 lawyer in mergers and acquisitions and in banking and finance by *IFLR 1000*; and a Tier-1 lawyer in corporate law, banking and finance, and mergers and acquisitions by *The Legal 500*.

He has a master's degree in Comparative and International Law from Southern Methodist University School of Law (Dallas, Texas, United States) and a bachelor's degree in Law from Universidad Iberoamericana in Mexico City.

He is the founding partner of Galicia Abogados, SC.

Ángela Garcia

Brigard Urrutia

With more than 10 years of experience, Ángela is senior associate of the corporate and M&A practice. She advises national and international clients in transactions for the acquisition and sale of shares or assets. She also advises her clients in connection with corporate reorganisations, the definition of structures to invest in Colombia and the negotiation of joint ventures and shareholders agreements, among others. Ángela has worked on deals for the acquisition and sale of companies in a wide range of industries such as oil and gas, mining, pharmaceutical, health services, aeronautical and infrastructure. She has also participated in cross-border reorganisations and has advised private capital fund and entrepreneurs in funding rounds for start-ups.

Ms García received her JD from Rosario University and holds an LLM from Northwestern University, a master's in International Law from Paris 2 University (Panthéon-Assas) and a master's 2 in Arbitration and International Trade Law from Versailles University.

Rita Ghanem

Shearman & Sterling LLP

Rita Ghanem is an associate in the project development and finance practice. She has varied Latin America project finance experience, advising both lenders and sponsors, leading financial institutions, US government agencies, and multinational corporate clients in connection with project financings, as well as acquisition financings, of energy and renewables projects in Chile, Mexico and other countries in Latin America. Her notable experience in the region includes representation of: the mandated lead arrangers and lenders on the Cóndor and Huemul renewable projects portfolio financings in Chile, owned by Mainstream Renewable Power Limited; the lenders in the financing of the $1.256 billion acquisition by Actis of the InterGen portfolio of energy assets in Mexico; the joint lead arrangers and bookrunners in the $260 million financing provided to Vista Oil & Gas, a Mexican company, for the purchase of certain oil and gas assets in Argentina from Pampa Energía and Pluspetrol

Resources; and the lenders on the $1 billion senior unsecured revolving credit facility to Braskem America and Braskem Netherlands, as borrowers and Braskem, as guarantor.

Denise Grant

Shearman & Sterling LLP

Denise Grant is a partner in Shearman & Sterling's bank finance practice. She advises financial institutions, including commercial banks and DFIs, as well as multinational and local corporations, in their secured and unsecured, domestic and cross-border, private financing activities, with a particular focus on Latin America. Denise's significant experience includes several notable transactions in the region including representing: the joint lead arrangers and bookrunners in the $260 million financing provided to Vista Oil & Gas, a Mexican company, for the purchase of certain oil and gas assets in Argentina from Pampa Energía and Pluspetrol Resources; international financial institutions in connection with $8 billion in credit facilities for PEMEX ('Syndicated Loan of the Year' by LatinFinance); and Alicorp in a US$500 million bridge loan to fund the acquisition of Intradevco. Twice lauded as one of the 'Most Influential Black Lawyers' by *Savoy Magazine*, Denise has also been named one of only six Tier 1 lawyers in Latin America-wide Banking & Finance by *Chambers & Partners* and one of only 14 'Leading Lawyers' in Banking & Finance by *The Legal 500 Latin America*.

Pablo Guerrero

Barros & Errázuriz Abogados

Pablo Guerrero is a partner in the corporate/M&A group of Barros & Errázuriz. With more than 25 years of experience, he has focused his practice in mergers and acquisitions, capital markets, securities, financing, investment and international commercial transactions in general.

He has been recognised in national and international publications as one of the leading M&A lawyers in the country, highlighting his extensive experience in leading most relevant M&A transactions in Chile in the areas of health, infrastructure, financial services education, real estate, and aquaculture, among others. He has a Master of Comparative Jurisprudence from New York University School of Law and a bachelor's degree in law from the Pontificia Universidad Catolica de Chile, where he has been a professor of Commercial Law for several years. He is a member of the Chilean Bar Association and the National Arbitration Center. Pablo is also the president and founder of Fundación Pro Bono in Chile (Pro Bono Foundation).

Daniel Hernández

Skadden, Arps, Slate, Meagher & Flom LLP

Daniel Hernández is an associate at Skadden, Arps, Slate, Meagher & Flom LLP. He represents multinational corporations, institutional and financial investors, family offices and other privately held companies in mergers, acquisitions, joint ventures, private equity and venture capital transactions, as well as other complex corporate transactions, concentrating in cross-border M&A throughout Latin America.

He has more than eight years of experience in cross-border M&A transactions involving Latin American parties, targets and assets, while based in New York, Brazil and Colombia. Daniel has an LLM degree from Harvard Law School and graduated first of his class from his JD at Universidad del Rosario (Colombia).

He is admitted to practice in New York and Colombia and is a foreign consultant admitted by the Ordem dos Advogados do Brasil (Brazilian Bar), São Paulo section.

Geraldine Ifrán

FERRERE

Geraldine Ifrán is a partner at FERRERE's corporate and commercial practice group and is member of the mergers and acquisitions practice.

She advises corporate clients in different sectors of the economy and leads work teams in due diligence procedures, purchase transactions and mergers. In her over 20 years of experience at the firm, she has been responsible for corporate advice to leading companies, including, among others: ACI Worldwide, Ahold Delhaize, Berlitz, Chevron, Key Safety Systems, Lactalis, Navios, P&G, The Hershey. She is the undisputed market leader in insurance, leading for more than 20 years the firm's insurance and reinsurance practice and assisting companies such as AIG, HDI, Liberty Mutual, MAPFRE, MetLife, SBI (FAIRFAX), SWISS RE, Zurich, among others.

She has broad experience in mergers and acquisitions, having led FERRERE's practice in many of the largest M&A transactions that took place in Uruguay in recent years.

Ifrán has been recognised by *Chambers*, *IFLR*, *Latin Lawyer* and *Legal 500*. In 2020, she was recognised as a leading female transactional attorney in *IFLR1000 Women Leaders*. She had already been recognised by *IFLR* in 2018, when she was named 'Best Female Corporate Lawyer in Latin America' in the Women in Business Law Awards.

Fulvio Italiani

D'Empaire

Fulvio Italiani is considered one of the leading M&A and corporate lawyers in Venezuela. He has participated in most of the significant acquisition, financing and oil and gas transactions taking place in Venezuela in the past years. Fulvio has been consistently ranked as a star individual for M&A/Corporate by *Chambers Latin America*. He was honoured with an award for 'Outstanding Contribution to the Legal Profession' at the 2013 Chambers Latin America Awards for Excellence. Before becoming a partner at D'Empaire in 1997, Fulvio worked as an associate at the New York offices of Skadden, Arps, Slate, Meagher & Flom from 1993 to 1996. He received a JD *summa cum laude* from Universidad Católica Andrés Bello in 1990.

Elías Jalife

Von Wobeser y Sierra

Elías is an associate of Von Wobeser y Sierra. He participates in the corporate, M& A, banking and finance, and telecommunications, media and technology areas. He has extensive experience in different aspects related to corporate and commercial transactions, and with transactions related to aspects of information technology and telecommunications, in which he has been directly involved during the stages of negotiation, document drafting and closing.

Elías also has broad experience in the review, drafting and negotiation of civil, commercial and IT contracts. In the firm, Elías has advised companies in general legal matters on the proper compliance with their corporate, regulatory and financial obligations. Elías has also advised companies whose primary purpose consists of the production and marketing of consumer goods, and therefore he actively participates in the Consumer Goods Industry Group.

Darío Laguado

Brigard Urrutia

Darío Laguado joined the firm in 2010 and is currently the chairman of the corporate and M&A practice. Laguado focuses his practice in advising clients in cross-border transactions across multiple industries and in advising private equity funds in their investments and divestments in the country, currently having counselled on transactions exceeding an aggregate amount of US$10 billion. Key representations include the merger of BVC and Deceval, the merger of ACE and Chubb, the merger of Colombia Telecomunicaciones and Movistar, the merger of Bank Itaú and Corpbanca, the acquisition by the Japanese company Itochu Corp. of an interest in Drummond, the acquisition by Éxito of several companies in the region, the transfer of Electricaribe's business to two new companies, and their sale to two new operators and the investment of SoftBank in Rappi, among others.

Some of the private equity funds that Laguado advises include Catterton, MAS Equity Partners, Carlyle, Tribeca Capital Partners and Brookfield Asset Management, among others. In addition, Laguado advises leading national and foreign companies in corporate matters, including joint ventures, shareholders agreements, privatisation law, directors' and officers' liability, etc. Some of his clients in this field include Itaú, EPM, Telefónica Internacional, Celsia, BBVA, ETB and Carvajal.

Before joining the firm, Laguado worked for three years as a corporate associate at Sidley Austin LLP in New York City, where he specialised in M&A, capital markets and finance, with particular focus in Latin America. Laguado is admitted to the practice of law in Colombia (2003) and New York (2008). Laguado received his JD from the Javeriana University and holds an LLM from the University of Harvard. He is also professor of Commercial Law and Corporate Law.

Maurizio Levi-Minzi

Debevoise & Plimpton LLP

Maurizio Levi-Minzi is an M&A lawyer with over 20 years of experience advising clients in cross-border acquisitions of a broad variety of assets including infrastructure assets and complex joint ventures. Levi-Minzi has led transactions in Latin America, the United States, Europe and Asia for private equity groups and strategic investors including Ambev, Barrick, Brookfield, Carlyle Group, Clessidra, CPPIB, CSN, GP Investments and Mitsui.

He is ranked as a leading lawyer for mergers and acquisitions in Latin America by *Chambers Global* (2020), *Chambers Latin America* (2020), *Latin Lawyer 250* (2019) and *The Legal 500 Latin America* (2019). Levi-Minzi is also recognised as a leading M&A lawyer by *IFLR1000* (2020) and has been named an 'Expert in Mining' by *Who's Who Legal* (2020).

Levi-Minzi is frequently invited to speak on trends related to cross-border private equity and M&A transactions involving Latin America. He is an adjunct professor at New York University, where he teaches cross-border M&A and has co-chaired the Practising Law Institute's programme 'Doing Business in and with Emerging Markets' for a number of years. Mr. Levi-Minzi is also outside counsel to the Emerging Markets Private Equity Association (EMPEA).

Levi-Minzi is fluent in Italian and Spanish and understands Portuguese.

Andrew M Levine

Debevoise & Plimpton LLP

Andrew Levine is a litigation partner at Debevoise & Plimpton and devotes a significant portion of his practice to investigative and compliance matters in Latin America, where he leads many of the firm's related initiatives. He is well recognised in the region and elsewhere for defending companies and individuals in criminal, civil and regulatory enforcement matters and for conducting internal investigations.

Levine serves as the go-to anti-corruption adviser to numerous leading global companies and represents many clients on corruption-related matters in Latin America, including the *Lava Jato*, *Zelotes*, *Carne Fraca* and *FIFA* scandals. He has led important representations in Argentina, Brazil, Chile, Colombia, Ecuador, Guatemala, Mexico, Peru, Uruguay and Venezuela, among other countries. In addition to his active defence and investigations practice, Levine frequently advises clients on a broad array of compliance matters, including conducting risk assessments, enhancing compliance programmes and mitigating risks presented by potential corporate transactions.

Levine is ranked as one of the top three lawyers for corporate crime and investigations in Latin America by *Chambers Latin America* and as a leading lawyer for FCPA by *Chambers USA*. In 2020, *Latin Lawyer* named Levine as International Lawyer of the Year, based on 'his profile in the market and the vast amount of work he has done to shape the development of anti-corruption and investigations work in Latin America'.

Paola Lozano

Skadden, Arps, Slate, Meagher & Flom LLP

Paola Lozano is a New York-based M&A partner at Skadden, Arps, Slate, Meagher & Flom LLP. She is the co-chair of Skadden's Latin America Group and the head of the firm's Spanish language corporate practice. She has also served as a member of Skadden's Policy Committee.

Paola has been repeatedly recognised by her clients and colleagues. Among others, she was *Latin Lawyer*'s 2019 International Lawyer of the Year; a *New York Law Journal 2019* Distinguished Leader and *Crain's New York* Business Notable Women in Law 2019. She has also been ranked by *Chambers* in Band 1 for Corporate M&A in Latin America (the first and only woman to achieve that ranking); and is also included as a top attorney in *Lawdragon 500* Leading Lawyers in America (2014–2020); *Latinvex Latin America*'s Top 100 Lawyers (2014–2020) and *Latinvex Latin America* Top 50 and Top 100 Female Lawyers (2013–2020).

Her M&A practice focuses on cross-border transactions throughout the Americas and globally, including mergers, acquisitions, dispositions, joint ventures, private equity and venture capital transactions, as well as other complex corporate matters. Her clients include Fortune 500 companies, multinationals, multilatinas, private equity and venture capital funds, family offices and other privately held companies.

She is admitted to practise in New York and Colombia.

Marisol Márquez

Von Wobeser y Sierra

Marisol Márquez is an associate of Von Wobeser y Sierra, mainly engaged in the M&A, corporate and banking and finance practices. With over nine years of experience, she has participated in complex cross border transactions and advised clients pertaining to all kinds of industries, including financial services and consumer goods, among others. Aside from her core practice in M&A and all aspects related thereto, her experience includes matters related to corporate governance, private equity, commercial contracts, banking, data privacy, IT transactions and financing. Her experience in a wide range of transactions allows her to provide creative solutions to the transactions she is involved in. She also advises clients in the merchant acquiring business and has participated in the filing before the Mexican authorities to register the first non-bank acquirer in Mexico. Additionally, she has been involved in several projects related to telecommunications, energy and natural resources, oil and gas and restructurings.

Monique Mavignier

BMA Barbosa Müssnich Aragão

Monique Mavignier is a partner at BMA's corporate and M&A practice with a solid track record on both the sell and buy sides of private and public M&A transactions, divestitures, financial matters, private equity investments, and corporate and securities law matters (including regulatory matters before the Brazilian Securities and Exchange Commission - CVM and the São Paulo Stock Exchange - B3 SA – Brasil, Bolsa, Balcão). She also provides strategic advice in hostile takeovers and has an extensive experience representing national and international companies doing businesses across a broad range of industries such as technology, food and beverage, retail, energy and construction.

Sergio Michelsen

Brigard Urrutia

Sergio Michelsen has been a member of Brigard Urrutia since 1992 and partner since 1994. With more than 30 years of extensive experience. Michelsen advises leading local and foreign companies in corporate M&A transactions as well as clients in respect of telecommunications, media and technology matters. He also counsels prominent families in connection with their private wealth. Over the course of his distinguished career, he has consistently been recognised in Colombia and internationally as one of Colombia's leading M&A and TMT practitioners. He has acted as lead counsel in many of Colombia's largest and most complex transactions.

Among his most prominent transactions some of which have won the 'Deal of the year' award in Latin America is the advice for SABMiller in the acquisition through a merger of Bavaria SA, the second-largest brewer in South America for US$7.8 billion, acting for the French retailer Casino in the sale of a controlling stake in GPA in Brazil and Libertad in Argentina (US$ 1.8 billion), and advising Millicom International in its merger with UNE-EPM (valued at US$4,348 billion).

He has participated in transactions for a value in excess of US$60 billion along his professional career. Michelsen also services on the boards of highly respected not-for-profit organisations.

Michelsen received his JD from the Andes University and holds a master's degree in Commercial Law from the University of Paris II, France. He also did an intensive course in Project Finance at the Euromoney Institute in New York and several negotiation and management courses at Harvard University. He has also been a professor and frequent lecturer in the national and international realm.

Pablo Mijares

Mijares, Angoitia, Cortés y Fuentes

Pablo is one of the founding partners of Mijares, Angoitia, Cortés y Fuentes.He has extensive experience in mergers, acquisitions and private equity transactions, as well as in public and private bidding processes.

He regularly advises buyers, sellers and investors in complex mergers, acquisitions and joint ventures, shareholders' conflicts and strategic planning of specific projects. He has for many years advised on real estate transactions for hospitality, commercial and residential projects.

He has extensive experience in cross-border and international transactions, which constitute most of his practice, representing Mexican and foreign entities. He has actively participated in various acquisitions and joint ventures involving insurers, banking businesses, as well as in the sale of high-value assets owned or controlled by governmental agencies.

Pablo is constantly ranked in legal industry publications as one of the best M&A lawyers in Mexico.

Francisco Antunes Maciel Müssnich

BMA Barbosa Müssnich Aragão

Chico Müssnich is a founding partner of BMA. He has unmatched experience in providing strategic advice in wide range of corporate matters and in highly complex national and international M&A transactions. Chico also provides strategic advice in hostile takeovers and corporate disputes and has been named one of the 15 most powerful lawyers in Brazil. He is frequently recognised as a leading lawyer in the legal sector's top rankings and publications and is constantly consulted by lawyers and law firms for his recognised expertise in highly intricate corporate transactions and disputes.

Estanislao Olmos

Bruchou, Fernández Madero & Lombardi

Estanislao Olmos is a partner in the general corporate and M&A department of. His practice focuses in mergers, acquisitions and divestures, involving both public and private companies. He regularly represents acquirers, sellers, targets, boards of directors, investors and shareholder groups in complex domestic and international merger and acquisition transactions. He is also member of the antitrust department, with strong experience in merger control-related matters. Likewise, he has significant experience in participating in restructuring matters, whether court-related or outside-of-courts.

Estanislao received a law degree, with honours, from the Law School of the Argentine Catholic University in 1998. He also received an LLM degree from the Columbia University School of Law in 2003.

Olmos has been regularly recognised in his field of practice for several consecutive years by *Chambers and Partners* and *International Financial Law Review*. Additionally, International Law Office and Lexology distinguished Olmos two times with the Client Choice Award in M&A (Argentina).

Stephen Pelliccia

SoftBank Group International

Stephen Pelliccia is director and senior counsel at SoftBank Group International, where he focuses on investment and fund matters for the SoftBank Latin America Fund. Previously, he was an associate at Greenberg Traurig, LLP and Cleary Gottlieb Steen & Hamilton LLP, where he negotiated M&A and capital market transactions in Latin America.

Mr Pelliccia received a BA from the University of Miami, a JD from Fordham University School of Law and an LLM from Comillas Pontifical University ICADE. He is fluent in English, Spanish, Portuguese and Italian, and is proficient in French.

Diego Pérez-Ordóñez

Pérez Bustamante & Ponce

Diego focuses on mergers and acquisitions and competition matters. In the field of M&A, he represents strategic buyers, sellers, investment banks and investment funds in international transactions, acquisitions, joint ventures, asset acquisition, share purchase agreements (SPAs), shareholder's agreements (SHAs), due diligence processes, closing of transactions and other complex corporate matters.

He is also experienced in competition control of mergers and acquisitions and in regulatory aspects of the area.

Estefanía Ponce

Posse Herrera Ruiz

Estefanía Ponce is a senior associate at Posse Herrera Ruiz. She has more than 12 years of experience in investment and commercial arbitrations under the ICC, ICSID, UNCITRAL, ICDR, Swiss and Bogotá Chamber of Commerce Rules, advising states, state entities, companies and foreign investors in transportation, oil and gas, infrastructure, port services and energy disputes, and in arbitration-related litigation. Estefanía has also acted as secretary in commercial and investment UNCITRAL and ICC arbitrations.

Estefanía has been admitted to the practice of law in Colombia, and to the New York and Paris bars.

Prior to joining the firm, she worked at Cleary Gottlieb Steen & Hamilton, Zuleta Abogados and Colombia's investment promotion agency. She has been adjunct professor at Los Andes University on postgraduate courses on international dispute resolution.

Carolina Posada

Posse Herrera Ruiz

Carolina Posada is a partner at Posse Herrera Ruiz. Carolina has over 20 years of experience in litigation before civil, and administrative courts, as well as before domestic and international arbitral tribunals. Her professional practice covers insurance and reinsurance law, as well as contractual liability and damages.

She is a member of the Latin American Arbitration Association (ALARB), a national arbitrator of the Arbitration Center of the Bogotá Chamber of Commerce, a national and international arbitrator of the Arbitration Centers of the Medellín Chamber of Commerce and the Cali Chamber of Commerce and friendly composer of the latter. She has acted as an expert in Colombian law before the United States courts.

In 2019, Carolina was recognised as the best litigator in Latin America by Euromoney Legal Group.

Admitted to practise in Colombia since 1997.

Alberto Rebaza

Rebaza, Alcazar & De Las Casas

Alberto Rebaza is founding and managing partner of Rebaza, Alcazar & De Las Casas law firm. He co-leads the mergers and acquisitions area. In addition to his master's in Virgina, he has studied at Georgetown University and England.

Alberto has been consistently considered by legal rankings as a leading lawyer in M&A, banking and finance.

He has been speaker at different conferences in Dublin, San Paulo, Bogota, Santiago, Panama City, Barcelona, New York City, Mexico City, Bogota and Singapore, among others.

He has also been director in several companies and organisations, such as Edegel (energy), Rigel Peru (insurance), Liderman (services), Amrop (services), IPAE, Pesquera Alexandra (fishing) and YPO, among others.

Very much involved in the arts world, Alberto is vice-president of the Lima Museum of Art (MALI), member of the international patronage committee of the Museo Reina Sofia and member of the Latin American Circle at Guggenheim Museum in New York City.

Ana Paula Reis

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Ana Paula is an expert in corporate law and regulatory matters (including before the Brazilian Securities and Exchange Commission - CVM, and the São Paulo Stock Exchange - B3 SA – Brasil, Bolsa, Balcão). Her practice is focused on listed companies. Ana Paula has extensive experience in public offerings (public distributions and tender offer procedures) and M&A transactions involving listed companies, and in assisting clients with respect to regulatory requirements and related issues, including corporate governance, executive compensation, as well as corporate restructuring and defence strategies in administrative proceedings.

Lisseth Rincon Manzano

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Lisseth Rincon Manzano is an associate in the finance practice. She is dual-qualified in New York and Venezuela, and is fluent in English, Spanish, Portuguese and other languages. Rincon Manzano has Latin America extensive experience, focusing her practice on advising investment and commercial banks, institutional investors, other financial institutions and corporations, in a broad range of complex financing transactions, including domestic and cross-border acquisition financings, asset-based credit facilities, multi-currency credit facilities, investment-grade credit facilities, club-deals, bilateral facilities, refinancings, debtor-in-possession financings, debt restructurings, and other secured and unsecured lending transactions.

Her notable work in the region includes representing: Itaú CorpBanca as borrower, on the amendment and restatement of its $465 million credit facilities pursuant to an integrated amended and restated credit agreement led by Standard Chartered Bank and Wells Fargo; the lenders on a $400 million financing for Gruma SAB de CV; and the lenders on a $150 million financing for Mabe SA de CV.

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Lawyer from the Universidad de los Andes with Master of Laws (LLM) from Columbia University. As a member of the corporate/M&A team, he advises clients in a wide range of topics related to business law and the acquisition and sale of companies including corporate law, mergers and acquisitions, commercial law, among others.

He has advised strategic investors and private equity funds in the acquisition and sale of companies and in the negotiation of shareholders' agreements in different areas of industry and services. He has advised government entities and buyers in privatisation processes under Law 226 of 1995.

Jared Roscoe

SoftBank Group International

Jared Roscoe is deputy general counsel at SoftBank Group International, where he negotiates transactions, manages litigation, provides regulatory and policy advice, and leads SoftBank's Committee on Foreign Investment in the United States (CFIUS) programme

Most recently, Mr Roscoe served as Senator Mark R Warner's senior banking counsel, advising the senator on financial services, economic policy, CFIUS and the China–US relationship. Previously, he served as senior adviser for domestic finance at the US Department of the Treasury. Before joining the Treasury Department, he was an associate at Sullivan & Cromwell LLP, where he negotiated transactions in Latin America, provided financial regulatory advice and conducted corporate investigations.

After graduating from New York University School of Law, Mr Roscoe clerked for Judge Roger L Gregory of the US Court of Appeals for the Fourth Circuit. His prior government service includes advising Congresswoman Zoe Lofgren on foreign affairs, trade and healthcare. Mr Roscoe received his BA from Pomona College.

Augusto Ruiloba

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Augusto Ruiloba is a natively bilingual (Spanish and English) and dual-qualified (New York and Peru) senior associate in Shearman & Sterling's project development and finance practice, advising on project financings, as well as acquisition financings of energy, renewables, mining and infrastructure projects across Latin America. His notable work includes: leading the Shearman team in the financing of the Cúbico Alten solar power projects ('Latin America Solar Deal of the Year' by IJGlobal); advising the lenders in the financing of the Cóndor Portfolio ('Renewables Deal of the Year Americas' by PFI); Fruta del Norte gold and silver mining project in Ecuador ('Latin America Mining & Metals Deal of the Year' by IJGlobal); the refinancing of the construction of the Longitudinal de la Sierra Norte Tramo 2 toll road project in Peru (constituted the first securitisation of PAMPI rights); and representing the joint-led arrangers and bookrunners in the $260 million financing provided to Vista Oil & Gas, a Mexican company, for the purchase of oil and gas assets in Argentina from Pampa Energía and Pluspetrol Resources. For two years running, he was recognised as a 'leading U.S. attorney with a special focus on Mexico' in *The Legal 500* Private Practice Powerlist (a list comprised primarily of international law firm partners) and in *The Legal 500* 'Next Generation Lawyers list for Latin America: International Firms, Projects and Energy'.

Luciana Tornovsky

Demarest

Luciana is a partner in Demarest's corporate and M&A area, holds a master's degree (LLM) from Harvard Law School and a postgraduate degree from the International Tax Program at Harvard University. She is the author of books such as *International Trade Law* (Aduaneiras, 2004), *Securities World 2005 – Jurisdictional Comparison* (European Lawyer, 2005) and *Business Laws of Brazil* (West, 2009–2010). Luciana is the head of Demarest's corporate social responsibility area, which encompasses the diversity and inclusion and *pro bono* groups. Luciana is ranked in *Chambers Global*, *Chambers Latin America*, *LACCA*, *The Legal 500*, *Who's Who Legal*, *Análise 500*, *LeadersLeague* and *IFLR*, among others.

Luciana is an officer of the International Bar Association; vice president of the Harvard Law School Association of Brazil; member of the executive committee of the Harvard Law School Association; member of the Harvard Business School Alumni Angels of Brazil; co-chair in Brazil of the Harvard Woman's Alliance; member of the board of CESA (the Center for the Study of Law Firms), member of the Lawyers Council for Civil and Economic Rights in the Americas, an initiative of the Cyrus R. Vance Center for International Justice associated to the NYC Bar; and member of the board of IDIS (the Institute for the Development of Social Investment).

Patricio Trad

Mijares, Angoitia, Cortés y Fuentes

Patricio appears in the main list of capital markets leaders, considered as a corporate finance all-rounder with broad experience in corporate transactions and structured finance matters.

He is also a relevant practitioner in M&A and energy practice areas. He has experience in mergers and acquisitions, buyouts, joint ventures and divestitures, securities regulation, corporate and structured finance, infrastructure, energy and general corporate law.

He regularly advises issuers in diverse local and cross-border tender offers, acquisitions, buyouts, and joint ventures advising both buyers and sellers, also institutional investors and private equity investors in different industries, including regulated industries and public companies.

In addition, he has collaborated in a variety of debt and equity issuances in the Mexican market and routinely advises diverse Mexican and foreign banks in lending transactions to Mexican companies and regulatory matters.

Appendix 2

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Edited by Paola Lozano and Daniel Hernández of Skadden, Arps, Slate, Meagher & Flom LLP, and containing the knowledge and experience of more than 40 leading practitioners, *The Guide to Mergers and Acquisitions* provides guidance that will benefit all practitioners acting in Latin American mergers and acquisitions.

M&A activity in Latin America has grown significantly in recent decades and deals are increasingly complex. This guide draws on the expertise of highly sophisticated practitioners to provide an overview of the main elements of deal-making in a region shaped by its cyclical economies and often volatile political landscape. Its aim is to be a valuable resource for business-people, investors and their advisers as they embark on an M&A transaction.

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