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Acquisition Finance

Colombia

Carlos Fradique-Méndez and María Fernanda Diago
Brigard Urrutia

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Law and Practice

Contributed by:

Carlos Fradique-Méndez and María Fernanda Diago
Brigard Urrutia see p.19



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1. MARKET

1.1 Major Lender-Side Players

The major lender-side players in the Colombian acquisition finance market include local banks, foreign banks, private equity funds and debt funds. Traditionally, local banks and foreign banks have been the main players, but in recent years, non-bank lenders, such as private equity funds and debt funds, have taken an important role in acquisition financings. This has been prominent, for example, in the project finance space, where funds have been participating as lenders to new sponsors in the acquisition of project companies (whether during the construction or operation stages) in areas such as infrastructure (eg, roads and airports) and energy (including renewable energy).

A key difference between fund lenders and bank lenders is that banks are subject to strict local regulation and oversight by the Colombian Superintendence of Finance (*Superintendencia Financiera de Colombia*), and, among other things, are subject to strict legal lending limits. As a result, high-value transactions will typically be structured as syndicated or club deals.

1.2 Corporates and LBOs

See **1.1 Major Lender-Side Players**, which applies to both corporates and leveraged buy-outs (LBOs).

1.3 COVID-19 Considerations

At the beginning of the COVID-19 pandemic (March – April 2020) and for a few months thereafter, there was a decrease in the number of M&A transactions in Colombia. This may have been due to uncertainty in the markets, bankruptcy of companies and volatility in foreign exchange rates. However, from May 2020, the market started to stabilise, and the number of M&A transactions is now increasing.

Other than a decrease in transactions generally, transaction timelines and required approvals have not been affected. However, legal documentation has seen certain COVID-19 related changes. For example, in certain transactions where lenders have identified that borrowers have a higher risk of bankruptcy due to COVID-19, they have requested more stringent covenants and more liquid security requirements. Moreover, agreements in recent transactions governed by New York law (typically used for USD-denominated loans where foreign lenders are involved) are increasingly including in their conditions precedent, covenants and “material adverse effect” definitions specific references to pandemics, most likely to give lenders more flexibility and a degree of subjectivity to trigger events of default and acceleration provisions.

2. DOCUMENTATION

2.1 Governing Law

Acquisition finance in Colombia is governed by Colombian commercial and contractual law. The Colombian Civil Code and the Colombian Commercial Code are the two main sources of law that regulate contractual relationships. They provide a certain flexibility to parties to regulate their contractual relationship in agreements entered into by such parties. However, Colombian law contains certain rules that are known as “public order rules” (*normas de orden público*), and parties to an agreement governed by Colombian law cannot agree to provisions that contravene such public order rules. For example, a rule that is considered of “public order” is that parties cannot have an illegal purpose when entering into a contract. Hence, a provision that violates a public order rule will not be valid under Colombian laws, or, if the purpose of an agreement violates a public order rule, then the entire agreement will not be valid under Colombian laws.

Acquisition-finance transactions in Colombia have had a significant influence from the United States of America (the US). In fact, a large percentage of financings in Colombia choose New York law as the applicable governing law for the transaction. Even when governed by Colombian law, transaction documents and contractual provisions in an acquisition financing are increasingly mirroring documents and provisions used in US financings.

The choice of governing law of the loan agreement will depend on a few factors: (i) the location of the lenders, (ii) the currency selected and (iii) the location of the buyer and/or seller. The most common laws selected to govern the main debt documents are New York law or Colombian law. New York law is typically selected when foreign lenders (such as offshore banks and offshore funds) are involved in the financing, or when the buyer and/or seller in the M&A transaction are located abroad. The currency selected for the loan can also influence the financing's governing law; typically, a transaction disbursed in US dollars will be governed by New York law, as foreign lenders will most likely be involved. When the transaction currency is Colombian pesos, however, local actors will act as lenders and documents will typically be governed by Colombian law.

However, security documents will always be governed by Colombian law when the collateral is located in Colombia. For example, in the acquisition of a Colombian target company, a pledge of equity interests of the Colombian target company is usually required, and the document will be governed by Colombian law.

2.2 Use of LMAs or Other Standard Loans

Colombia does not have a form or standard loan market agreement. A handful of local law firms that are the major players in acquisition

financings have developed standard provisions that have become generally acceptable when such firms are involved in the preparation and negotiation of agreements. Also, local banks tend to have their own internal forms of credit agreements, security agreements, pledge agreements, guarantee agreements and promissory notes, and in local financings where they participate, it is common for them to request the use of their forms when it is a single-lender deal. For syndicated and club loans, there will almost always be one or two major law firms involved, and those law firms' form agreements are generally used. It is also common to use documentation from precedent transactions, particularly when the same parties are involved, or when the transaction has a similar structure or similar characteristics to a previous one.

Documentation for cross-border transactions governed by New York law is prepared by New York counsel (except for certain local law matters that may require the input of Colombian counsel). These agreements may follow model clauses adopted by certain industry groups, such as the model form credit agreement issued by the Loan Syndications & Trading Association (LSTA) or the model form note purchase agreement of the American College of Investment Counsel (ACIC). New York law firms will generally be the ones that prepare and negotiate these documents, with the help of Colombian counsel in specific items.

2.3 Language

Pursuant to Article 251 of the Colombian Civil Procedure Code, in a judicial or administrative proceeding in Colombia, parties are required to provide documentary evidence, such as agreements, in Spanish. In the event that the original document is not in Spanish, an official translation will need to be provided.

Local financings (ie, loans provided by Colombian entities to Colombian parties) will have all documentation in Spanish. In cross-border financings, however, the main loan agreements will typically be drafted in English, as such agreements will be governed by New York law. However, in the event that parties seek to submit the agreement as evidence in a Colombian proceeding (which can happen in a foreclosure proceeding involving Colombian collateral), an official translation to Spanish will be required.

However, ancillary documents such as guarantees, security agreements, trust agreements and promissory notes over Colombian assets and looking to be enforced in Colombia will be governed by Colombian law and will be drafted in Spanish. In some cases, in cross-border transactions, these documents are prepared in a double column format (Spanish with English translation next to it), but, in the event of inconsistencies, the Spanish-language version of the agreement will prevail.

Finally, for the enforcement of collateral that has been registered in the National Registry of Movable Assets (*Registro Nacional de Garantías Mobiliarias*) (Registry of Movable Assets), a copy of the relevant security agreement(s) (or a summary thereof signed by the guarantor) will need to be provided and, even though the rules do not expressly require the documents to be in Spanish, an analogy to Article 251 of the Colombian Civil Procedure Code suggests they should be. See **5. Security** for more information regarding security interests registered in the Registry of Movable Assets.

2.4 Opinions

It is customary to provide legal opinions in an acquisition finance transaction, in cross-border financings. Sometimes, a local financing may also require that a legal opinion be provided. In Colombia, both counsel to lenders and coun-

sel to borrower may be asked to provide a legal opinion.

In cross-border financings, counsel from multiple jurisdictions may be involved. At a minimum, if the transaction is governed by New York law, the financing documents will require that both New York counsel and Colombian counsel provide a legal opinion.

New York counsel to the borrower and/or to the lenders (as required in the loan documents) typically provides a customary legal opinion covering enforceability of the New York law-governed documents against the borrower, guarantors and other obligors party thereto, and opining that such documents are legal, valid and binding against those parties under New York law.

Colombian counsel to the borrower or the lenders may be asked to provide customary legal opinions generally covering the following:

- the existence and due organisation of the Colombian opinion parties;
- corporate capacity and due authorisation of the transaction documents governed by Colombian law with respect to the Colombian opinion parties;
- no conflict with Colombian opinion parties' corporate/organisational documents;
- no conflict with Colombian laws;
- no governmental authorisations or filings required, and, if so required, were obtained;
- enforceability of the Colombian law-governed documents against the Colombian opinion parties (eg, borrower, guarantors and other obligors party thereto) and opining that such documents are legal, valid and binding against those parties under Colombian law;
- if the financing is secured, creation, perfection, registration, and, in some cases, ranking, of security interests granted in Colombia; and

- other opinions may be included on a case-by-case basis.

3. STRUCTURES

3.1 Senior Loans

The most common structures used in acquisition financings are senior secured loans. Depending on the amount of the loan, there will be one lender (single-lender financings) or multiple lenders (syndicate or club financings). Security provided will often include a pledge of the shares of the target company and, more often than not, a pledge on the “commercial establishment” (*establecimiento de comercio*) of the target company (see **5.1 Types of Security Commonly Used**).

In a syndicate or club deal, senior lenders will rank *pari passu* and will have a first-priority security interest over collateral (subject to Colombian bankruptcy laws, which contain certain priorities by law). In some cases, subordinated debt may also be involved in the transaction, and the junior lenders will be unsecured or receive a second-degree lien on collateral. In order to govern the relationship among multiple lenders and secured parties, creditors in a transaction will likely enter into an intercreditor agreement and, in most cases, appoint an administrative agent and a collateral agent to act on their behalf. See **4. Intercreditor Agreements**.

3.2 Mezzanine/PIK Loans

Mezzanine financings are hybrid financings that have the characteristics of debt and equity. Mezzanine debt ranks below senior debt but above equity, hence, in the event of bankruptcy, a mezzanine lender will be paid after senior lenders are paid, but before shareholders are paid. Examples of mezzanine financings used in Colombia are subordinated debt, unsecured debt, convertible notes, warrants, and preferred stock.

Payment-in-kind (or PIK) loans are not common in Colombia in the acquisition finance space. However, recent years have seen a handful of PIK loan transactions. These can be found in the private equity space, where funds use a hybrid of equity and convertible debt to acquire companies, minimising their risk by getting paid before shareholders in the event of a bankruptcy, or by converting their notes or exercising their warrants in the event the company has a positive performance. However, Colombian law imposes certain restrictions regarding payment in kind. Under Colombian law and pursuant to opinions issued by the Superintendence of Companies (*Superintendencia de Sociedades*), a payment of dividends to be made in kind (other than the payment of dividends with shares of stock) is possible in exceptional circumstances where (i) the shareholders’ meeting has expressly authorised the payment in kind when declaring the dividend payment, and (ii) the shareholders receiving the dividends have expressly accepted the payment of their dividends with the respective asset.

Colombia also has special rules regarding the use of warrants and convertible notes. When considering these in the financing structure, creditors should be mindful that shareholders of the issuing company should also be bound by the obligation that is being assumed by the company with the issuance of the convertible notes or warrants, since, when the time comes, it is the shareholders’ meeting that will need to approve the issuance of shares when warrants are exercised or notes converted. This can be regulated via a shareholders’ agreement or by having the shareholders execute the loan agreement or an ancillary document to the loan agreement, whereby the shareholders are bound to comply with the obligations that have been assumed by the company with respect to these instruments.

In some cases, certain European development or import/export agencies have also opted for

hybrid models of financing. Since the purpose of these agencies is to help finance projects that contribute to a country's infrastructure and development, they tend to use medium-term (about three to seven years) hybrid financing structures where they acquire a minority stake (typically less than 25% equity) in a project company or its holding company (such as in a special-purpose vehicle (SPV)) and at the same time provide subordinated debt to the target company. This injects capital and permits project companies or their sponsors to access structured debt for the construction of a project where the senior lenders will have priority over payments and security. These agencies will commonly seek an exit between years three and seven after making their investment.

3.3 Bridge Loans

A bridge loan can be used in an acquisition financing when a purchaser requires faster access to resources, cannot acquire long-term debt or intends to refinance the loan in the short or medium term.

In Colombia, a bridge loan is granted for a period between one and five years, but companies typically refinance and pay the bridge loan before its maturity. More often than not, a lender of a bridge loan will also participate as a lender in its refinancing.

In some acquisitions where the purchaser buys 100% of a company, the purchaser obtains a bridge loan to close on the acquisition, and, post-closing, re-finances the loan at the target level, and pays its bridge loan through dividend payments or an inter-company loan. Nevertheless, Colombian law requires that dividend distributions be made from liquid net profits of the company, and, hence, this structure will only work if the company has enough profits.

3.4 Bonds/High-Yield Bonds

The issuance of bonds in Colombia is regulated by Decree 2555 of 2010. Although this regulation does not restrict the issuance of a particular kind of bond, the ones typically issued in Colombia are secured bonds, mortgage bonds and unsecured bonds, and, to a lesser extent, subordinated debentures, put bonds, callable bonds, variable-rate bonds (floaters), syndicate bonds and convertible bonds.

The size and depth of the Colombian securities market is relatively small compared to overseas markets. Although some companies have issued bonds to finance acquisitions, this is not very common due to the size of the Colombian market. Companies seeking large issuances tend to do so in overseas markets, such as in the US and Europe, pursuant to Rule 144A and Regulation S of the US Securities Act of 1933 and, more recently, under Section 4(a)(2) of the US Securities Act.

3.5 Private Placements/Loan Notes

In general, a securities' offering in Colombia is deemed a public offering when addressed to 100 or more known potential investors or to an undetermined number of persons. The 100-investor threshold includes the number of investors to whom securities were offered, regardless of the number of actual purchasers. Securities to be offered publicly must be registered in the National Registry of Securities and Issuers (*Registro Nacional de Valores y Emisores*, or RNVE) and are subject to prior approval of the Superintendence of Finance.

A private offering is one that meets one of the following conditions:

- the offering is addressed to fewer than 100 specifically identified investors;

- the offering is made to the shareholders of the issuer (as long as there are fewer than 500 shareholders);
- the issuer is a public utilities company that is offering securities to shareholders or investors, when the company is undergoing a corporate restructuring; or
- the offering is part of a stock-option plan.

Regarding stock option plans, Colombian corporations, their parent companies, affiliates, or subsidiaries domiciled in Colombia or abroad may offer stock to their employees (ie, those who have a valid and existing employment contract) and/or their directors. The offering must be part of a benefit or compensation plan and, for employees, it must be included in writing in their employment contract. If these requirements are not met, the stock offering will be deemed a public offering and authorisation from the Superintendence of Finance will be required.

Finally, in recent years, some Colombian issuers have also opted for raising capital through private placements in the US under Section 4(a)(2) of the US Securities Act of 1933.

3.6 Asset-Based Financing

The most common structures used in acquisition finance are secured loans. As mentioned above, loans made for the purpose of acquiring equity interests in other companies will generally require, at a minimum, a pledge of the equity of the target company, and, more often than not, a pledge of the commercial establishment (*establecimiento de comercio*) of the target company. In some cases, security over other types of collateral is given, such as real estate, equipment or inventory; however, these are less common in the context of acquisition financings. See Section 5. **Security** for a discussion on assets that are commonly provided to secure acquisition financings.

4. INTERCREDITOR AGREEMENTS

4.1 Typical Elements

Intercreditor agreements come into play when there are multiple lenders and multiple parties that are sharing the same security. Senior and junior lenders, hedge providers, administrative agents, collateral agents and trust agents may all be parties to an intercreditor agreement.

In general terms, an intercreditor agreement provides, among other things, common rules for creditors and secured parties:

- to declare an event of default and accelerate the loan;
- to initiate collection proceedings and enforce collateral;
- to grant voting rights to creditors, depending on their seniority and participation in the loan;
- for the sharing of payments;
- for the meeting and voting process required to make decisions; and
- in some cases, for the appointment of an intercreditor agent.

In cross-border transactions governed by New York law, the intercreditor agreement will most likely be governed by New York law, even when there is participation by local banks.

Local financings in the form of syndicate or club deals typically will also have an intercreditor agreement (*acuerdo entre acreedores*), which will be governed by Colombian law.

4.2 Bank/Bond Deals

4.1 Typical Elements also applies to bank/bond deals.

4.3 Role of Hedge Counterparties

Hedge agreements are common in transactions with floating rates or denominated in foreign

currency. Hedge counterparties are commonly ranked *pari passu* with senior creditors and will also be parties to the intercreditor agreement (if any) and share payments and collateral with senior creditors.

More often than not, hedge counterparties will also be one or more lenders in the main loan transaction. However, they will have specific rights and obligations as hedge providers in the intercreditor agreement, in addition to any rights and obligations they may have as lenders.

Derivatives transactions are highly regulated in Colombia. Rules issued by the Colombian Central Bank impose certain requirements to foreign hedge-providers when entering into transactions with Colombian residents. Among other things, foreign hedge counterparties will need to comply with certain minimum conditions to be able to enter into derivatives transactions with Colombian residents, and derivatives transactions executed with foreign counterparties will need to be registered with the Colombian Central Bank.

5. SECURITY

5.1 Types of Security Commonly Used

Security provided in an acquisition finance transaction will often include a pledge of the shares of the target company and, more often than not, a pledge on the “commercial establishment” (*establecimiento de comercio*) of the target company. A “commercial establishment” is a set of assets organised for a common business purpose. Such assets include, among other things, movable assets, intellectual property, equipment, inventory, machinery and contracts with clients and suppliers.

Rarely, a high-value deal may include a more structured security package that can involve the creation of a trust, pledges over bank accounts,

pledges over trust rights, pledges over material agreements, pledges over subordinated debt, and mortgages on real estate, among others. This may be the case, for example, for a project finance transaction involving the direct or indirect acquisition of multiple project companies in construction stage, as these transactions typically involve high principal amounts and a higher risk of non-payment for lenders.

5.2 Form Requirements

In 2013, Congress adopted Law 1676 of 2013, commonly known as the Movable Assets Security Law, or *Ley de Garantías Mobiliarias* (Law 1676), to promote access to loans by expanding the assets, rights and actions that may be subject to a security interest by simplifying the process of creation, perfection, ranking and enforcement of collateral made up of movable assets.

Pursuant to Law 1676, security interests over movable assets in Colombia are created when parties enter into a security agreement and when that agreement contains, at a minimum, the following:

- the proper identification of, and execution of the agreement by, the secured party and the grantor;
- a complete description of the collateral;
- a description of the secured obligations; and
- the maximum amount to be secured by the collateral.

These security interests are perfected when the security is registered before the Registry of Movable Assets that is managed by *Confecámaras*. Depending on the assets that make up the collateral, additional perfection requirements may apply. See **5.3 Registration Process** for a summary of the registration process.

Security over equity interests and over “commercial establishments” are the most commonly used in acquisition finance, and they fall within the scope of Law 1676. Additional perfection requirements may apply to these assets. See **5.3 Registration Process**.

Some acquisition-finance transactions may include real estate as collateral. Security interests over real estate are created when the relevant parties enter into a mortgage agreement. Pursuant to Article 2434 of the Colombian Civil Code, the mortgage agreement must be executed by means of a public deed (*escritura pública*) before a notary public (or a Colombian consular officer if executed abroad). Additionally, pursuant to Article 2435 of the Civil Code, the public deed must be registered before the Public Instruments Registration Office (*Oficina de Registro de Instrumentos Públicos*) situated where the real estate is located. A mortgage will only be valid and enforceable when it has been elevated to a public deed and duly registered in the Public Instruments Registration Office.

5.3 Registration Process

Movable Assets

Security interests over movable assets are perfected when the relevant security interest is registered by the secured party in the National Registry of Movable Assets (*Registro Nacional de Garantías Mobiliarias*) (Registry of Movable Assets). Registration in the Registry of Movable Assets must be done by the creditor/secured party, and the registration process is completed online by accessing an online platform. The registration process can be completed within one or two business days. In order to file a security interest, the relevant creditor/secured party must create and maintain an electronic account with the Registry of Movable Assets. If the creditor/secured party does not have a registered user, it will need to create one, and this process may take from one to five business days.

Registration before the Registry of Movable Assets requires that the secured parties provide, at a minimum, the following information, as it is set forth in the relevant security agreement:

- the proper identification of the secured parties and the grantor;
- a detailed description of the collateral;
- the maximum amount to be secured by the collateral; and
- the term of the security interest. If a term for the security is not specified, the registration will default to a term of three years, counted from the initial registration date.

Certain assets require additional registration requirements in order to be perfected. For example, security over shares of stock needs to be registered in the issuing company’s stock ledger, security over intellectual property rights must be registered in the relevant intellectual property registry, and security interests on automobiles need to be registered before the National Vehicle Registry (*Registro Nacional de Automotores*, or RUNT). Considering that, as of the date of this article, the Registry of Movable Assets is not inter-connected to the other registries, security over these “special” assets will only be perfected when registration is completed in both the Registry of Movable Assets and the relevant asset’s special registry.

It should be noted that Law 1676 does not cover security interests over securities listed in the Colombian Stock Exchange (*Bolsa de Valores de Colombia*, or BVC). Listed securities may be pledged in favour of third parties if they comply with certain requirements established by the Colombian Stock Exchange and the rules of the relevant Colombian central securities depositories (such as the Centralised Securities Depository of Colombia (*Depósito Centralizado de Valores de Colombia* or DECEVAL) of the Colombian Stock Exchange and the Central Securities

Depository (Depósito Central de Valores, or DCV) of the Colombian Central Bank), in which case, the relevant depository will “block” or immobilise the pledged securities to prevent their trading.

Real Estate

Security over real estate is perfected with the registration of the relevant public deed of mortgage before the Public Instruments Registration Office (*Oficina de Registro de Instrumentos Públicos*) situated wherever the relevant real estate is located. Registration fees and notary public fees will apply, and those fees will depend on the amount being secured by the mortgage (ie, the amount of the secured obligations) that is included in the mortgage agreement. If the parties do not establish a maximum amount to be secured by the mortgage, the parties are free to set a nominal amount of the mortgage for registration fee purposes.

5.4 Restrictions on Upstream Security

Upstream security is security that is granted by a company to guarantee the debt of its parent company or its direct or indirect beneficial owner. Upstream security is a type of third-party security, since the security is being granted to support the obligations of a third party (in this case, its own parent company or beneficial owner) and not to support its own obligations. This upstream security may be accompanied by an upstream guarantee (or “subsidiary guarantee”).

In Colombia, three issues arise in the context of upstream security and subsidiary guarantees. First, the subsidiary issuing the guarantee must have corporate capacity to provide third-party security and to guarantee the obligations of a third party. This will need to be established in the subsidiary’s corporate purpose set forth in its bylaws.

Second, the subsidiary must show that providing such security has a means-to-end relation-

ship to the company’s business purpose; that is, that such an act will bring a corporate benefit to the subsidiary. A “corporate benefit test” is not regulated under Colombian law, so a conservative approach suggests that the shareholders of the company will need to establish that such a benefit exists in a meeting of the shareholders.

Third, the Superintendence of Companies has said that the granting of security and guarantees to support a parent company’s (or beneficial owner’s) obligations is a transaction that is presumed to have an inherent conflict of interest for an officer or director of the company, and, therefore, must have shareholders’ approval. Pursuant to case law of the Superintendence of Companies, transactions between a company and its beneficial owner (or other companies under the control of the same beneficial owner) (known as “related party transactions” or RPTs) are generally affected by an embedded conflict of interest. According to the Superintendence of Companies, an officer or director of the controlled company is beholden to its beneficial owner, due to that beneficial owner’s ability and power to dismiss or replace the director if he or she fails to approve an RPT. The director thus lacks an objective judgement to approve these transactions. Procedurally, what Colombian law requires in such cases is that the shareholders be summoned to a meeting in which they would discuss and waive the conflict of interest indicated by the relevant director or officer, and to do so, they must be given sufficient information to be able to analyse and resolve the conflict of interest.

5.5 Financial Assistance

Colombian law does not contemplate a general “financial assistance” test for an upstream security to be granted by a subsidiary. However, a subsidiary must satisfy certain requirements in order to be able to grant security on behalf of its parent company or guarantee debt or obliga-

tions of its parent company or beneficial owner. See **5.4 Restrictions on Upstream Security**.

5.6 Other Restrictions

See **5.4 Restrictions on Upstream Security** for Colombian law restrictions on upstream security and upstream guarantees.

See also **7.1 Equitable Subordination Rules** and **7.2 Claw-Back Risk**, which contain fraudulent conveyance and payment priority rules in an insolvency or reorganisation proceeding.

5.7 General Principles of Enforcement

The enforcement of security will depend on the assets that make up the collateral. Movable assets, and, in some cases, real estate, are the assets that commonly constitute collateral in an acquisition-finance transaction.

Movable Assets

In addition to general collection proceedings (*procesos ejecutivos*) before Colombian courts, Law 1676 of 2013 established a special expedited proceeding for enforcing security interests over collateral that qualifies as “movable assets” (*garantías mobiliarias*) under Law 1676, and when that security has been properly created and perfected. Real estate, aircraft, aircraft engines, helicopters, railway rolling stock, spacecraft and other types of mobile equipment regulated by Law 967 of 2005 are excluded from the scope of Law 1676, so special creation, perfection and enforcement rules will apply to security over those assets.

As a matter of Colombian public order laws, Law 1676 will only apply if the assets are located in Colombia and the relevant security agreement is governed by Colombian law.

In an event of default, Law 1676 sets forth three foreclosure procedures for security over movable assets:

- a direct payment mechanism;
- a special proceeding for the foreclosure of the security; and
- a judicial proceeding.

Generally, under these three proceedings, once the foreclosure petition has been filed, the secured party may gain possession of the secured assets, and, to do so, the secured party may have to request a court to order the seizure of the secured assets if the guarantor refuses to deliver them.

Direct payment mechanism

A direct payment enforcement mechanism is only permitted if expressly agreed in the relevant security agreement, or when the secured party holds possession of the secured asset in Colombia. In these events, the secured party may use the collateral to repay the debt owed to it by:

- filing a foreclosure form before the Registry of Movable Assets;
- notifying the grantor about the filing of the foreclosure form and indicating the selected foreclosure mechanism;
- unless the parties agree otherwise, valuation of the collateral will be determined by an appraisal made by an appraiser who is selected from an appraiser list established by the Superintendence of Companies (the appraisal must be performed at the moment of delivery of the asset or if the secured party already has possession of the asset) and that appraisal will be binding for the grantor and the secured party;
- in the event that the value of the collateral exceeds the amount of the secured obligations, the secured party must deliver any excess amounts to the other secured creditors of the grantor or to the grantor itself, as the case may be. In this case, a secured party must post a judicial bond (*depósito judicial*) in

favour of those secured creditors or the grantor, as applicable; and

- if the secured asset is not delivered by the grantor, the secured party may request a judicial authority to order the seizure and delivery of the asset, without requiring further procedure.

Special foreclosure procedure

Law 1676 also has the option for parties to agree on a foreclosure procedure and set the rules that will be applicable to that foreclosure in the relevant security agreement. If parties agree to such a foreclosure procedure, a secured party may initiate foreclosure extra-judicially by following that procedure before a chamber of commerce or a notary public.

In the event that parties to a security agreement agree to applying the special foreclosure procedure but do not include the applicable procedural rules in the agreement, Article 65 of Law 1676 has some default rules that can apply. The steps include:

- the filing of a foreclosure form with the Registry of Movable Assets;
- delivery of a copy of the foreclosure form to any other secured creditors registered in the Registry of Movable Assets to allow them to participate in the foreclosure procedure;
- if no objection to the foreclosure procedure is made, and if the collateral has not been delivered to the secured party by the grantor, the secured party may ask a judicial authority to order the seizure and delivery of the collateral;
- sale of the collateral to repay the secured obligations, and any excess must be delivered to other secured creditors or the grantor, as applicable. In the case of an excess, the secured party that is foreclosing must post a judicial bond (*depósito judicial*) in favour of the other secured creditors or the grantor, as applicable; and

- if the secured asset is not delivered by the grantor, the secured party may request a judicial authority to order the seizure and delivery of the asset, without requiring further procedure.

Judicial proceeding

The third option is for a secured party to initiate a judicial collection proceeding (*proceso ejecutivo*) in accordance with Article 61 of Law 1676 and Articles 467 and 468 of the General Procedural Code. When initiating a judicial foreclosure proceeding, the secured party is also required to file a “foreclosure form” before the Registry of Movable Assets. This filing will serve as notice to the grantor and will also serve as a “collection instrument” (*título ejecutivo*) for purposes of the judicial collection proceeding. If the grantor does not attend the proceeding or does not provide a defence, the secured party may request the judge to issue a ruling ordering the transfer of ownership of the collateral to the secured party as payment in full for the secured obligations.

Real Estate

A mortgagee may request the adjudication of the mortgaged property, for the total or partial payment of the secured obligation, by means of a judicial allocation proceeding (*proceso judicial de adjudicación*), or a mortgage foreclosure proceeding (*realización especial de la garantía real*), as established in Articles 467 and 468 of the General Procedural Code. This judicial proceeding can last between one to three years.

Corporate Guarantees

Personal guarantees, known as *fianzas* and *avales*, may be enforced via a judicial collection proceeding (*proceso ejecutivo*) as established in the General Procedural Code. A judicial collection proceeding (*proceso ejecutivo*) can last between one to three years. See **6. Guarantees** for a discussion on personal guarantees in Colombia.

6. GUARANTEES

6.1 Types of Guarantees

Under Colombian law, a “personal guarantee” is an irrevocable payment obligation that is assumed by the guarantor to guarantee amounts owed by a third party (ie, the borrower or direct obligor). They are considered “accessory obligations”, and, therefore, their existence depends on the existence of a “main” obligation; in other words, the guarantee cannot exist if there is no main obligation that is being guaranteed. As a result, a guarantee must make express reference to the main obligation that it is guaranteeing.

There are different types of personal guarantees in Colombia. For example, the “*fianza*” is a type of guarantee of collection, and as such, requires that the beneficiary of the guarantee first exhaust remedies against the borrower/direct obligor before they can collect against the guarantor. “*Fianzas*” can be of a contractual nature (ie, agreed by parties in a contract), a legal nature (ie, imposed by law) or of a judicial nature (ie, imposed by court order). Another type of guarantee is the “*aval*”. As opposed to a *fianza*, an *aval* is a guarantee of payment, not just of collection, which means that the creditor can demand payment in a first instance either of the debtor of the original/main obligation or of the guarantor. Guarantees can also be joint and several (*garantías solidarias*), which means that the guarantor will be liable for the full amount of the obligation it is guaranteeing and not just for a portion of it.

In the context of an acquisition financing, in addition to executing a guarantee agreement, a guarantor is typically also required to provide a promissory note (*pagaré*) in favour of the creditor of the main obligation to facilitate collection. The promissory note is a personal guarantee in and of itself. These promissory notes are commonly drafted so that they are joint and several

obligations of the issuer/guarantor with respect to the main obligation of the debtor. As a result, creditors can demand full payment of the obligations from the guarantor without first having to exhaust remedies against the debtor.

Promissory notes issued under Colombian law serve as “collection titles” (*títulos ejecutivos*), which makes them an instrument that permits the initiation of a judicial collection proceeding (*proceso ejecutivo*) in Colombia. Judicial collection proceedings are generally more expeditious (they may take between one to three years) than an ordinary judicial proceeding (*proceso ordinario*), which can take up to 15 years.

Personal guarantees do not need to be registered. They are in personae obligations, and, therefore, are created with the execution of the relevant instrument or guarantee agreement.

Parent guarantees and subsidiary guarantees are commonly used in acquisition-finance transactions. A parent guarantee (downstream guarantee) is a guarantee issued by the direct or indirect parent of the purchaser/borrower to guarantee the obligations of the purchaser/borrower under the loan documents. A subsidiary guarantee (upstream guarantee) is a guarantee issued by a direct or indirect subsidiary of the purchaser/borrower. Other affiliates of the purchaser/borrower may also provide guarantees, although these are less common. All of these are considered “third-party guarantees” under Colombian law, so they must comply with the laws applicable to, and the organisational documents of, the relevant guarantor. For special rules regarding some of these guarantees, see **5.4 Restrictions on Upstream Security**, which also applies to upstream guarantees.

6.2 Restrictions

See **5.4 Restrictions on Upstream Security** and **5.5 Financial Assistance**, which also apply to upstream guarantees.

6.3 Requirement for Guarantee Fees

Colombian law does not require the payment of guarantee fees. However, for guarantee-type instruments issued by financial institutions, such as standby letters of credit, banks and other financial institutions will typically charge a fee to the debtor for issuing such instruments.

Finally, the Colombian Registry of Movable Assets requires that the relevant secured parties or, if applicable, the administrative agent or collateral agent on behalf of the secured parties, be the ones to file the relevant security documents before the Registry. Secured parties will be required to pay a small fee to the Registry when registering security interests (about USD10, subject to the exchange rate).

7. LENDER LIABILITY

7.1 Equitable Subordination Rules

Bankruptcy regimes in Colombia contain equity subordination rules. Colombia's insolvency regime under Law 1116 of 2006 (Law 1116) include rules for both reorganisation and liquidation proceedings for individuals and companies with permanent commercial activities in Colombia. However, certain entities are excluded from the scope of Law 1116 of 2006, such as entities in the health industry, stock exchanges, agricultural exchanges, private equity funds, entities subject to the oversight of the Superintendence of Finance, government-owned companies, public utilities companies and non-merchant individuals, among others.

Law 1116 sets forth a priority of payments to creditors whenever a company that is subject to

this regime enters into an insolvency or reorganisation proceeding. Each obligation is assigned a class, and each class is ranked in order of priority of payment according to Law 1116, regardless of what those parties have agreed separately with the debtor.

Pre-insolvency obligations (that is, obligations that accrued prior to the commencement of the insolvency proceeding and that will be subject to the proceeding) must be paid in accordance with the reorganisation or allocation agreement. However, the payment of these obligations must follow the payment priority order set forth in the Colombian Civil Code, which is summarised as follows:

- first-class obligations – include employment-related and tax-related obligations;
- second-class obligations – include obligations that are secured by moveable assets;
- third-class obligations – include obligations that are secured by real estate;
- fourth-class obligations – include obligations of strategic suppliers (understood as suppliers of raw materials or any supplies necessary for the production or transformation of goods or the rendering of services);
- fifth-class obligations – include all other obligations that are not ranked in the above-mentioned classes.

In addition to the foregoing, pursuant to Article 69 of Law 1116, in an insolvency proceeding, “postponed creditors” will be paid when all other creditors have been paid. Obligations of creditors that will be legally postponed include debts with controlling shareholders or controlled subsidiaries, creditors involved in restricted transactions, penalty clauses and claims of creditors that are characterised as “specially related entities” to the debtor. Specially related entities include: (i) legal entities related to the debtor, given their status as a “subsidiary” or “controlling entity”,

and (ii) a company's officers and representatives, fiscal auditors and judicial attorneys and representatives (for their salaries and professional fees that were not registered in the relevant fiscal period, as well as any indemnifications, fines and interest from settlement hearings, judicial rulings or similar acts). If a creditor requests the postponement of another creditor's obligations under Article 69, that creditor will have the burden of proof and will have to provide evidence that the other creditor is a specially related entity vis-à-vis the debtor.

Exceptions to the aforementioned rules include new obligations that arise from funds lent to the debtor after its admission into the insolvency proceeding and that are aimed at the recovery of the debtor. These are given a certain priority under insolvency laws.

7.2 Claw-Back Risk

Article 74 of Law 1116 of 2006 contains fraudulent conveyance rules whereby any creditor, or the promoter/liquidator of the insolvency proceeding, may challenge before the insolvency court certain acts and contracts executed by the debtor before the commencement of an insolvency proceeding, and seek their revocation. A transaction may be "clawed-back" in this scenario if:

- it is found to have inflicted damages upon creditors, or has affected the priority order for payment of obligations owed by the debtor, or has affected the assets that make up the debtor's estate;
- it was executed or performed within the applicable claw-back period, as follows:
 - (a) for bilateral transactions or any act that results in the transfer or conveyance of property, including the transfer to a collateral trust, payment of pre-insolvency obligations, granting or cancellation of a lien, and execution of lease agreements or bail-

ment contracts with the effect of obstructing the insolvency proceeding, the claw-back period will be of 18 months' duration prior to the commencement of the insolvency proceeding;

- (b) for gratuitous acts or donations, the claw-back period will be of 24 months' duration before the commencement of the insolvency proceeding;

- (c) for amendments to the company's by-laws, the claw-back period will be of six months' duration before the commencement of the insolvency proceeding; and

- it appears that the relevant buyer, creditor, lessee or bailee, as applicable, did not act in good faith when entering into the transaction.

8. TAX ISSUES

8.1 Stamp Taxes

There is no stamp tax applicable to the execution of the loan agreement or to the payment of principal or interest.

8.2 Withholding Tax/Qualifying Lender Concepts

Interest derived from loan agreements granted to Colombian-resident borrowers is sourced and taxed as Colombian income.

Generally, the applicable withholding rate to foreign lenders is 20%, if the term loan's maturity is less than one year, or 15%, if longer. However, exceptions apply. For example, in some cases, withholding rates can be reduced if the lender is in a jurisdiction with which Colombia has entered into a treaty to avoid double taxation. In contrast, the withholding rate is higher (31% for the year 2021 and 30% starting in 2022) when the lender is located in a tax haven. A 5% reduced rate could apply to interest payments made to foreigners for loans granted for a term of at least eight years and to be used for infrastructure projects under public-private associations. These

are just some examples, and other exceptions apply.

Interest and withholdings accrue on a linear method, regardless of the schedule of payments.

From a practical standpoint, loan documents typically include a gross-up provision and allocate the risk of changes in law to the borrower.

8.3 Thin-Capitalisation Rules

According to current rules, thin-capitalisation (“thin-cap”) rules limit the deductibility of interest payments to related parties for debts that exceed a 2:1 debt-equity ratio in a given fiscal year.

As an anti-abuse mechanism, the thin-cap rules are applicable to indebtedness with related parties, both directly and indirectly (ie, in schemes that conceal the presence of a related party). The thin-cap rules state that the concealment of a related party acting as a creditor may be reached, among others, through back-to-back schemes, as well as a particular guarantee mechanism called an *aval*. See **6. Guarantees** for a discussion on guarantees.

The thin-cap rule is not applicable to entities that are under the oversight of the Superintendence of Finance (such as Colombian financial institutions), taxpayers that conduct factoring activities, businesses in a non-productive stage, mass transit companies and public utilities infrastructure projects.

9. TAKEOVER FINANCE

9.1 Regulated Targets

In Colombia there are several industries that are subject to special regulations. Entities that operate in these industries are subject to the oversight of one or more governmental agen-

cies (Regulated Entities). For example, financial institutions such as banks, broker dealers, pension fund managers and insurance companies are subject to the oversight of the Superintendence of Finance and public utilities companies are subject to the oversight of the Superintendence of Public Utilities Services (*Superintendencia de Servicios Públicos Domiciliarios*).

When the target company in an acquisition is a Regulated Entity, the acquisition must follow an approval process, including, among others, requesting approvals or non-objections (as applicable) to the applicable regulator that exercises oversight, as well as approvals or non-objections (as applicable) to the antitrust authority.

Special industry regulations may also impose restrictions on the possibility of Regulated Entities to acquire debt and grant security interests over their assets.

9.2 Listed Targets

In Colombia, a takeover of listed companies can only be made by means of a public tender offer (*oferta pública de adquisición*, or OPA), whenever a bidder intends to acquire or become the beneficial owner of 25% or more of the listed company’s stock with voting rights. The term “beneficial owner” and the procedure for a public tender offer are regulated by Decree 2555 of 2010.

In order to carry out a public tender offer, the bidder must seek prior authorisation of the Superintendence of Finance and must carry out the transaction through the Colombian Stock Exchange (*Bolsa de Valores de Colombia*, or BVC). Public tender offers must comply with the requirements of Title 2 of Book 5 of Decree 2555 of 2010 and the procedural rules of the BVC, which include, among other things, a requirement that the offeror provide certain guarantees

(which may be in the form of cash collateral, standby letters of credit, insurance policies or government bonds) prior to making a tender offer.

10. JURISDICTION - SPECIFIC FEATURES

10.1 Other Acquisition Finance Issues

All jurisdiction-specific issues are discussed in the preceding sections.

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AUTHORS



Carlos Fradique-Méndez is a senior partner with more than 30 years of professional experience. He is a licensed practitioner in Colombia and a member of the New York Bar. A

former CLO of the Ministry of Finance/DoT, Mr Fradique heads the firm's finance practice and has been a pioneer in the project, corporate and structured finance arena, as well as in the capital markets and private equity and venture capital industry. He has been active in many local and international financing transactions, acting for sponsors, concessionaries, financial institutions, multilateral entities (including the Inter-American Development Bank (IADB), the International Finance Corporation (IFC), the Charities Aid Foundation (CAF) and the World Bank), issuers, underwriters and the public sector.



María Fernanda Diago is a partner in the banking and financial services group. She is admitted to practise law in Colombia and in the State of New York. She advises clients in

domestic and cross-border financial, banking and capital markets transactions, representing companies, investors, banks, funds, multilaterals and other entities in all types of financings, including project, acquisition and corporate financings, syndicated credit agreements, debt offerings and refinancings. She advises domestic and foreign clients in day-to-day financial, banking and securities regulation, derivatives, contracts and corporate matters. She is also experienced in M&A and private equity matters.

Brigard Urrutia

Calle 70 Bis
No. 4 - 41
Bogotá
Colombia

Tel: +57 1 3462 011
Fax: +57 1 3100 609
Email: cfradique@bu.com.co
Web: www.bu.com.co

Brigard
Urrutia