LATIN LAWYER

THE GUIDE TO MERGERS AND ACQUISITIONS

THIRD EDITION

Editors
Paola Lozano and Daniel Hernández

The Guide to Mergers and Acquisitions

Third Edition

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This article was first published in November 2022
For further information please contact insight@latinlawyer.com

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Published in the United Kingdom by Law Business Research Ltd
Holborn Gate, 330 High Holborn, London, WC1V 7QT, UK

www.latinlawyer.com

ISBN 978-1-83862-903-8

Printed in Great Britain by
Encompass Print Solutions, Derbyshire
Tel: 0844 2480 112

Acknowledgements

The publisher acknowledges and thanks the following for their learned assistance throughout the preparation of this book:

Barros & Errázuriz Abogados

BMA Barbosa Müssnich Aragão

Brigard Urrutia

Bruchou, Fernández Madero & Lombardi

Credit Suisse

Debevoise & Plimpton LLP

Demarest Advogados

D'Empaire

Galicia Abogados

Gómez-Pinzón

Mijares, Angoitia, Cortés y Fuentes

Morrison & Foerster

OpenStore

Pérez Bustamante & Ponce

Pérez-Llorca

Philippi Prietocarrizosa Ferrero DU & Uría

Posse Herrera & Ruiz Abogados

Rodrigo, Elías & Medrano Abogados

Shearman & Sterling LLP

Skadden, Arps, Slate, Meagher & Flom LLP

SoftBank Group International

Von Wobeser y Sierra

Publisher's Note

M&A activity continues to grow exponentially across Latin America – both in terms of volume of deals and their complexity. As Paola Lozano and Daniel Hernández of Skadden, Arps, Slate, Meagher & Flom LLP point out in their introduction to this third edition of *The Guide to Mergers and Acquisitions*, this is putting even more pressure on practitioners to say abreast of current topics and emerging trends in this complex and fast-moving environment.

Latin Lawyer and LACCA are therefore delighted to publish this latest edition of *The Guide to Mergers and Acquisitions*. It aims to meet this need by bringing together the knowledge and experience of leading experts from a variety of disciplines to provide guidance that will benefit all practitioners working across the region. The guide also carries an insightful roundtable on the impact of political instability on dealmaking, bringing together voices from a variety of jurisdictions to offer advice and key takeaways on how to navigate this mercurial landscape.

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

It is our great pleasure to have worked with so many outstanding individuals to produce *The Guide to Mergers and Acquisitions*. If you find it useful, you may also like the other books in the Latin Lawyer series, including *The Guide to Infrastructure and Energy Investment* and *The Guide to Corporate Crisis Management*, as well as our jurisdictional references and our new tool providing overviews of regulators in Latin America.

Contents

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, new trends and a complex and changing environment. 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. Such variables include, in addition to the proposed terms of a particular deal, 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.

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

This guide is designed to provide an overview of certain critical aspects of current M&A dealmaking 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 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 on an M&A transaction.

The years to come will likely be marked by challenging economic, political and social conditions impacting the globe at large and Latin America in particular. M&A practitioners will be required to adapt as governments and markets respond to current inflationary trends, a looming global recession, depreciation of local currencies against the US dollar, the gas and energy crisis created by the Russia–Ukraine conflict, continued worldwide polarisation, the rise of populist movements to power and the continued economic and social effects of the covid-19 crisis, including its long-lasting impact on supply chains.

Part I of this guide is an edited transcript of a roundtable discussion moderated by Paola Lozano of Skadden, on the impact of social unrest and political instability in M&A dealmaking, held in September 2021, at a time when the worst and most widespread global healthcare crisis the modern world has known, covid-19, 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.

A panel of leading M&A practitioners based in Argentina, Brazil, Chile, Colombia, Mexico, Peru and Spain addressed the then current social and political climate in the region and its direct and indirect impact on M&A activity. The panel discussed regulatory changes that may impact dealmaking in the region, providing a useful detailed overview of the specific political and social landscape in some of the major Latin American markets, as well as specific contractual issues that have or may become relevant or need to be addressed in the current environment. Among others, the panel touched on issues such as deal certainty, ESG investing, increase in carve-out deals, regulatory changes and merger control regimes, as well as hot industries such as energy, infrastructure and fintech. The roundtable also touched on the perspective and perception of foreign investors, leveraging the participation of Iván Delgado from Pérez-Llorca in Spain and Paola's and Skadden's experience from the US perspective, and on the drivers of current high levels of deal activity (record-breaking in some cases), which may be based on an asymmetry in risk perception and more optimistic expectations than what is perceived by local actors. Among such factors, the participants shared their views on the role played by entrepreneurs, venture capital and private equity funds in driving deal activity. Finally, the panel discussed the expectations for 2022 M&A activity and some of the challenges and drivers that could impact the market appetite for local targets, many of which materialised, until the cycle started changing and new world order issues emerged.

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.

Federico Grebe, Rafael Boisset, Claudia Barrero and Martín Cruzat of Philippi, Prietocarrizosa Ferrero DU & Uría in Chile, Colombia and Peru discuss 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 dealmaking 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 of SoftBank and Stephen Pelliccia of OpenStore 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.

Lina Uribe García and Juan Pablo Caicedo De Castro of Gómez-Pinzón in Colombia discuss the challenges faced when undertaking M&A transactions involving governments or government-owned entities, including a comprehensive overview of the regulatory intricacies of privatisations in Colombia. As noted by the authors, the current political and economic landscape and the fiscal deficit facing governments across the region will likely be responsible for an increase in the number of privatisations in the years to come, despite the recent rise to power of left-leaning governments in various countries in the region.

We close Part II with the insight provided by senior Latin American M&A investment banker Nicolas Camacho of Credit Suisse in New York, who gives 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-pandemic 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 chapter 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 more relevant as distressed M&A may become more relevant with economic challenges driven by political instability and social unrest. The authors also offer an interesting overview of recent changes in the Venezuelan M&A space, as the market gradually transitions from a predominantly distressed environment to more normalised dynamics.

Randy Bullard, Giselle C Sardiñas, Diego Rodriguez and Karina Vlahos of Morrison & Foerster in Miami address the incorporation of global environmental, social, and governance (ESG) practices and standards into Latin American deal-making, consistent with increased global attention to sustainability, ESG and impact investing. The authors provide a valuable overview of this trend in various countries in the region and discuss in detail how such trend impacts an array of aspects of M&A transactions, including due diligence efforts and drafting of contractual provisions such as covenants and representations and warranties. The authors also provide commentary on significance of ESG matters for successful post-closing business integration.

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 provide interesting insights on the driving factors in the choice of forum for dispute resolution in M&A agreements in the region, and provide commentary on the prevalence of arbitration in Latin American deals and relevant factors to select the seat of international arbitration proceedings. The chapter also draws interesting conclusions and notes potential trends to develop in the region on the basis of surveys involving some of the most reputable Latin American firms.

For the third edition, the editors and Ralph E Pérez, counsel at Skadden, discuss the increased availability and implementation of representations and warranties insurance (RWI) in Latin American M&A deals. The chapter addresses recent increased penetration of RWI as an important risk allocation tool in the region, often fostering deal activity in a turbulent environment, providing solutions and aligning parties' interests and risk appetite in a manner often not possible without an industry based on the assumption of transactional risk. The chapter provides an overview of the 'nuts and bolts' of RWI, including cost, risk allocation in deals with RWI, the underwriting process, the process for claims under a RWI policy, limitations on coverage and insurability of particularly complex and costly risks (including money-laundering, corruption and tax risk), factors driving the availability of RWI for a particular transaction, relative benefits of RWI for sellers and buyers, and the interaction between the RWI policy and the purchase agreement.

Part IV addresses selected topics critical to M&A dealmaking, 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 and Pedro de Elizalde 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 dealmaking 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 and Andres Brown-Pérez of Pérez Bustamante & Ponce in Ecuador provide an overview of the particularities of due diligence efforts and risk assessment with respect to Latin American targets. The authors combine 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. They also discuss statutes of limitations (with a focus on Ecuadorian law), and trending issues such as the use of legal tech in due diligence.

Last, Luis Burgueño, Alberto Córdoba 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

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 IV

Select Topics Critical to Dealmaking

CHAPTER 14

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 intent 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 chapter. 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

1 Pablo Mijares is a founding partner and Patricio Trad is a partner at Mijares, Angoitia, Cortés y Fuentes.

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 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 consumated'.[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;

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).

- 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.

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.

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 a 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 cost-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.

Recent changes – preliminary agreements during 2020–2021

In light of market uncertainties and volatility created by the covid-19 pandemic, we have seen that parties in M&A transactions are negotiating more detailed term sheets, letters of intent and MOUs. This ensures that the parties have a good business understanding of the transaction, and mitigates the risk of not closing due to covid-19-related issues or market disruptions in general.

We have seen a significant increase in the granularity of topics included in term sheets due to valuation uncertainties – such as contingent purchase price formulas and requests for more detailed financial diligence. The effects of the covid-19 pandemic are considered to be the result of material adverse change. Also, parties have been more willing to agree to binding preliminary agreements. All of these changes have resulted in a longer negotiation process of preliminary agreements, but have helped parties feel more confident that transactions will close on the agreed terms.

Recent tax reforms

Recent tax reforms in Mexico, as in other countries in the region, have raised important issues that affect M&A transactions, increasing both tax risk to analyse and related requirements to be observed. Tax risk is generally not addressed in term sheets or other preliminary documents. Term sheets may specify whether the transaction will be structured as an asset or stock deal. However, it is normally too early to address the tax structuring details of an M&A deal. Nonetheless, the parties should discuss early on whether any preclosing reorganisation is expected and related tax risk, and how such risk, if any, is to be allocated among the parties.

To emphasise this matter, the introduction of a General Anti-Avoidance Rule (GAAR) in 2020 by means of which the Mexican tax authorities may recharacterise a transaction solely for tax purposes when they deem it is tax driven or it does not derive from a valid business reason, has required taxpayers to look at business reorganisations more closely, and to carefully measure any potential tax exposure in advance. Furthermore, the tax reform of fiscal year 2022 introduced additional mechanisms by means of which the Tax Administration Service may question the business reasoning for a transaction in the context of financing structures or corporate reorganisation within the same group, which are sometimes required to attract third-party investments.

Likewise, the introduction of mandatory disclosure rules, by means of which taxpayers or tax advisers are required to disclose certain specific schemes deemed potentially abusive, have also brought specific concerns to the parties when entering a new M&A transaction.

Other things to consider when entering an M&A transaction are compliance issues that may pose challenges when trying to close, and which should be outlined, not necessarily as part of the term sheet, but to be considered well in advance. On this front, Mexico's recent tax reforms have increased the requirements that sellers must comply with when seeking tax efficient exits by being subject to tax on the resulting capital gain at a 35 per cent rate (and not at a flat 25 per cent rate on the gross proceeds). These requirements include, among others, the obligation to designate a Mexican resident legal representative who must be jointly liable for any potential omitted taxes due by the sellers, and who must be granted powers to dispose of, and to subscribe negotiable instruments with respect to, the sellers' assets. Finally, as of fiscal year 2022, Mexican resident legal entities and investment vehicles are obligated to disclose their ultimate controlling beneficiary individuals. This information needs to be updated on a timely basis. It may therefore represent an important item to consider in the context of an M&A transaction.

APPENDIX 1

About the Authors

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. For many years, he has 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.

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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.

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Published by Latin Lawyer and LACCA, edited by Paola Lozano and Daniel Hernández of Skadden, Arps, Slate, Meagher & Flom LLP, this third edition of *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 dealmaking in a region shaped by its cyclical economies and an often volatile political landscape. Its aim is to be a valuable resource for business people, investors and their advisers as they embark on M&A transactions.

ISBN 978-1-83862-903-8