LATIN LAWYER

THE GUIDE TO MERGERS AND ACQUISITIONS

FOURTH EDITION

Editors
Paola Lozano and Daniel Hernández

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Publisher's Note

M&A activity continues to grow exponentially across Latin America – in terms of both 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 fourth edition of *The Guide to Mergers and Acquisitions*, this is putting even more pressure on practitioners to stay 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.

My thanks go 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*.

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London
December 2023

The Guide to Mergers and Acquisitions

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Fourth Edition

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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 persons, 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. These 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.

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. 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 have 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 challenging economic, political and social conditions impacting the globe at large and Latin America in particular in the recent past are expected to remain for some time. M&A practitioners are required to adapt as governments and markets respond to inflationary trends, the risk of a global recession, deep fluctuations of local currencies against the US dollar, continued economic and geopolitical implications of the Israel–Hamas and Russia–Ukraine conflicts, continued worldwide polarisation and the rise of populist movements to power.

Part I of this guide is an edited transcript of a roundtable discussion held in September 2023 and moderated by Paola Lozano of Skadden in New York, on the impact of macroeconomic and other environmental factors on M&A activity, including the effects of inflation and recession forecasts and limited availability of financing, all while certain investors confirm their appetite for assets in the region. The panel also discussed opportunities presented by the nearshoring phenomenon and key geopolitical developments, including the tensions arising from the evolving US–China relationship, among other M&A hot topics and trends, such as the relationship between fintech and venture capital, the energy market, the relative depth (or lack thereof) of most Latin American capital markets and ESG investing.

The panel comprised leading M&A practitioners in Latin America: Iván Delgado of Pérez-Llorca in Madrid, Manuel Galicia of Galicia Abogados in Mexico City, Lao Olmos of Bruchou & Funes de Rioja in Buenos Aires, Luciana Tornovsky of Demarest Advogados in Sao Paulo and Jaime Robledo Vásquez of Brigard Urrutia in Bogota. The selection of panellists provides the perspective of highly experienced and regarded practitioners in the most active M&A markets in Latin America, as well as that from the two foreign jurisdictions that most frequently source foreign investors in large transactions in the region.

At the time this panel was held, the Israel–Hamas conflict had not begun and the election of Javier Milei as Argentina's President (which is expected to bring significant changes in economic and foreign exchange control policies) had not occurred. Both events and the evolution of election outcome potential in Colombia, Mexico and the US, among others, are expected to have the capacity to redefine geopolitical dynamics relevant to M&A activity in the future.

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 Sergio Torres of Deveboise & Plimpton in New York address M&A transactions involving private equity funds and other institutional investors, including the intrinsic challenges thereof and recommended protections in partial acquisitions.

Joaquin Perez Alati and Mariana Seixas of SoftBank Investment Advisers in New York and Miami discuss the impact of venture capital investments in recent years in Latin America, and provide an overview of the forms developed by the National Venture Capital Association for venture capital investments and transaction terms expected by a US-based venture capital fund in their investments in Latin America, based on their experience with these forms. They also discuss the need to adjust the forms developed in Silicon Valley to the factual circumstances and complexities of the region.

Isabela Martins Xavier and Gustavo Deucher Brollo of Araújo e Policastro Advogados in Brazil provide a practical overview of M&A deals involving family-owned businesses, and the many particularities and complexities involved in these transactions, including the need to ascertain early on the power structure and the alignment of interests and objectives within the family group, the entanglement between business and family assets, and specific issues relating to due diligence on family-owned businesses.

We close Part II with a discussion from Lina Uribe García and Juan Pablo Caicedo De Castro of Gómez-Pinzón in Colombia of 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.

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.

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 and Daniel Villa of Morrison & Foerster in Miami address the incorporation of global environmental, social and governance (ESG) practices and standards into Latin American dealmaking, 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 the 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 the significance of ESG matters for successful post-closing business integration.

The editors and Ralph E Pérez at Skadden, Arps, Slate, Meagher & Flom in New York 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 an 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.

Hans Peter Goebel Caviedes and Carlos Rodolfo Ríos Armillas of Nader, Hayaux & Goebel in Mexico conclude Part III by discussing public company M&A, public offerings and dual listings, hostile takeovers and shareholder activism from the perspective of the Mexican market. The chapter provides a comprehensive overview of relevant regulation in Mexico and underscores the larger size and depth of the Mexican and Brazilian capital markets, compared to other jurisdictions in Latin America, and highlights the potential for the development of additional types of M&A transactions that are common in developed markets but nascent in Latin America, such as hostile takeovers.

Part IV addresses select topics critical to M&A dealmaking, outside the main transaction agreement.

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 these documents. The chapter also provides an insightful overview of the main issues revolving around confidentiality agreements, exclusivity agreements and cost-sharing agreements.

Luis Burgueño, Alberto Córdoba and Elías Jalife of Von Wobeser y Sierra in Mexico 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 the 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.

Juan Bonet, Eduardo Bonis, Ricardo Güell and José Francisco Iturrizaga of Deloitte Legal in Uruguay, Argentina, Costa Rica and Peru provide a regional perspective on antitrust, other regulatory approvals and key interim operating covenants, which are paramount to closing certainty.

Juan Andrés Bretón and Roberto Carrillo of FerradaNehme in Chile provide an overview of fiduciary duties and insider trading regulations in Chile and their application to the M&A stages, particularly with respect to due diligence and the exchange of information thereunder.

Last, Raúl Fernández-Briseño, Francisco Javier Garibay Güémez and Eduardo Rojas Brandao of Mayer Brown Mexico, SC address acquisition finance for M&A deals in Latin America, including an overview of current trends, factors impacting the structuring of an acquisition finance, the main acquisition finance documents, and agreements and perspectives from each party thereto, as well as matters to be addressed that are specific to Latin America.

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 we 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, business persons 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 I

The Latin Lawyer M&A Roundtable

CHAPTER 1

The Latin Lawyer M&A Roundtable

Latin Lawyer hosted a debate on 11 September 2023 to explore the latest developments in this area. The discussion covered core aspects of the complex M&A landscape in Argentina, Brazil, Colombia and Mexico – as well as perspectives from the United States and Spain.

The discussion was chaired by Paola Lozano of Skadden in New York. Also participating were Iván Delgado of Pérez-Llorca in Madrid, Manuel Galicia of Galicia Abogados in Mexico City, Lao Olmos of Bruchou & Funes de Rioja in Buenos Aires, Luciana Tornovsky of Demarest Advogados in Sao Paulo and Jaime Robledo Vásquez of Brigard Urrutia in Bogota.

The following is an edited transcript.

Paola Lozano: Hello and good morning everyone. I am very happy to be joined by such an esteemed panel, all top practitioners in their jurisdictions – I couldn't be in better company. Let's start by thinking about the overview of the M&A market today in the region. We are in the middle of the third quarter. At the beginning of this year, we were coming in with strong headwinds against M&A activity. There were severe concerns about a global recession and the impact this may have on global M&A activity. I would say – and we will explore this today through this dialogue across Latin America – that we have fared better than expected in the region. I say that because even though global levels of M&A activity measured by dollar value are lower than the previous year (and this is also the case for Latin America), in comparative terms, Latin America's activity has fallen less than M&A activity in the United States, and we have seen unexpected pockets of very interesting dealmaking in each of the countries represented in our panel.

The headwinds were led significantly by concerns of inflation: the interest rates going up in the United States and the reduction of liquidity in the market, making it more difficult to finance M&A transactions. There were a couple of bank failures in the United States that sent some waves into the acquisition financing market. The impact of geopolitics, both globally and locally, inflicted pain in the region and are still impacting issues like appetite for M&A, risk appetite generally, the options for financing deals, and definitely a shift in the jurisdictions that attract capital.

In the region generally, we've seen a few strategics take the lead in taking more risk in jurisdictions where others are not willing. We've seen global private equity retreat a little bit, but with some entrants that are cash rich and willing to grow in a market that still allows for penetration of capital participants. We've also seen an interesting phenomenon as some of the wealthiest family groups in each of these countries face issues in their own jurisdiction, they're starting to go to other countries inside and outside of Latin America to deploy capital to diversify. All of these things have helped reduce the negative impact of these economic global trends in the M&A market.

Having said that, there are still difficulties in completing M&A transactions. I would say that what we see from New York is a buyer's market, as compared to the seller's market that we had in prior years. This is shown by the pricing, which is still significantly impacted. We see sellers expecting high valuations, we see buyers unwilling to oblige. That dynamic requires more complex structuring for both bankers and lawyers. We've seen, as I said, surprising pockets of very complex and interesting deals, including a tendency towards hostiles. We have seen some of the changes within the political landscape also impact dealmaking. We're going to talk in those terms about Argentina, Mexico and Colombia in particular, and how the administrations in power have taken decisions that have significantly impacted certain sectors.

I want to turn to our panellists. Let's start with Lao, in considering landscape in Argentina and whether some of the topics that I have presented hold true as to what is impacting the levels of activity there.

Lao Olmos: Thank you, Paola. Argentina is a very specific country in terms of its M&A trends because of local nuances like high inflation – probably the highest in LatAm and the world – coupled with foreign exchange regulations. And the combination of these two factors has led to less M&A activity. Nonetheless, we have seen a significant transaction deal flow. When it comes to retail sectors, you see more a seller's side, but when it comes to oil and gas, you see a buyer's market. Mainly that is because Argentina is increasing significantly its hydrocarbon resources, mainly from non-conventional sources coming out of Vaca Muerta. So we are seeing a lot of investment there that has not ceased and has not changed, although we are in the middle of an election year, in which you would typically see less activity compared to other years. That is triggering a lot of associated investments related to how to pump out from Vaca Muerta to the world. So we are seeing investment in pipelines, treatment facilities and port facilities as well. That is creating a lot of activity.

On the other hand, we are seeing, amid a worldwide battle for resources, Argentina has 20 million metric tonnes of lithium that have been untapped. A lot of Chinese entities are bidding for those resources, for example, the latest Pluspetrol transaction in 2022: a US$1 billion ticket for a small piece of the lithium resources. That is still going on. Argentina has a very strong title legal framework when it comes to mining. Lately, we are seeing in Chile and Bolivia a less favourable environment for that type of investment. This is creating a lot of interest again in mining, mainly in lithium but also in copper and other rare minerals. A less active but still very meaningful source of M&A is everything related to power generation and transmission. Argentina needs to revamp its transmission lines and there are buildings that will be put in place for next year and that is creating a lot of activity, mainly from local players. As you indicated, when it comes to stressful scenarios, local players seem to be more willing to take on risk and they are seizing every opportunity when a foreign entity decides to exit Argentina. Coupled with that, you see more often than before family offices being very interested in tapping into opportunities, and we can mention the DIRECTV transaction as an example. The other investments in pharma, cable production, manufacturing and especially venture capital with technology and fintech, where Argentina still has a very significant entrepreneurship base, creativity and certainly resilience because we are kind of used to suffering everything and we are still pushing for exit.

Lozano: That's very interesting Lao – we've definitely seen some of these issues in our deals with you. And we might spend a little bit more time on this because as you said, it probably is the market where inflation is most evident. The question that comes to mind is do you think that the inflationary pressures in Argentina are actually impacting the way in which we draft our agreements and negotiate our deals in terms of pricing?

Olmos: Well, it only applies when you have a deferred closing and that is only in the very limited sector of regulated industries. What we are seeing is more appetite for the so-called 'lock box' system, which is not the common M&A practice here in Argentina – we are more inclined to closing accounts. But it seems that now we are seeing the upside for that system so that you transfer the risk the moment you sign. Transactions are usually done in dollar-denominated currency but because of inflation and mainly because of foreign exchange regulations, it has not been uncommon, last year and during this year as well, to see peso-denominated transactions. The reason being that companies are building up a lot of peso funds here. They cannot dividend out because of foreign exchange regulations, so they are using those pesos to buy assets for individuals that can actually carry out foreign exchange transactions.

Lozano: Thank you, Lao, that's exactly what I wanted you to touch upon because I think this contrasts with the historical preferences of New York lawyers, and Iván will tell me if it's the same perception for European clients. We are used to clients insisting on using the 'strong currency'. Obviously with the accumulation of capital due to exchange controls, pesos abound in Argentina, so they are available to be deployed for M&A, which is a trend that we don't mind, because otherwise you would have reduced M&A activity even further. This has allowed folks to deploy capital to carry out M&A deals but driven by local players.

Let me move to Luciana now in Brazil. Generally I think what the press reports and what globals have seen is that with the change in administration, there appeared to be fears that there was going to be a further reduction of market-friendly activity and therefore potentially M&A, but we have not seen that from New York. I'll hand it over to Luciana to give us the overview for Brazil.

Luciana Tornovsky: Good morning and thank you so much for the invitation Paola and the Latin Lawyer team. So the market for M&A deals in Brazil has been growing in recent years. We saw a decrease in the number of M&A deals in the first quarter of 2023. I think this is because of the change in government, as Paola was saying, so, Lula is back again. Even with all the political and economic turbulences that we have been experiencing, I can say that Brazil continues to be attractive for investors, mainly because of its huge market, its natural resources and experienced labour force in some sectors.

If we think about trends in M&A deals in Brazil, I believe that the following are the most important: first, cross border transactions. Compared to the past, we have seen even more Brazilian companies expanding their presence in the US and Europe through acquisitions in sectors such as financial services, agribusiness and consumer goods. Examples of that are Vale, Banco Inter and other Brazilian companies that are investing abroad. Those outbound transactions were not very common in the past for Brazilian or for Latin American companies, so I think it is a very good sign.

Regarding inbound investments, we continue to see many international companies looking to enter or to expand their operations in Brazil, as well as private equity (PE) funds trying to find good opportunities here. Another trend is the consolidation in some industries: some sectors have been pursuing consolidation, such as banking, healthcare and retail. The main reason for that is to gain market share and to foster efficiency through strategic acquisitions. A third trend would be privatisation. The Brazilian government has been carrying out initiatives aiming at the privatisation of some state-owned companies, which will open opportunities for private investments in sectors like infrastructure, energy and telecommunications.

And last, we cannot forget about innovation and technology. The tech sector in Brazil has been growing very fast and has been attracting both domestic and foreign investors. I have seen several M&A transactions of tech companies, especially fintechs, and in areas such as e-commerce and software development.

Lozano: That's great, Luciana. One quick follow up for you on the relationship between fintechs and venture capital. We read that some of the big players in venture capital had a little more of a conservative attitude this year than they have had before – an example that comes to mind is SoftBank where there have been significant changes. We have seen deceleration in investments by venture capital players in the fintech sector. Have you seen that translate in deal activity or is that being replaced by other sources of capital?

Tornovsky: That's true, Paola. Compared to last year we had a decreasing number of venture capital investments in fintechs in Brazil. The good news is that this year one of the Brazilian fintechs that this client invested in became a unicorn. We are very proud of that and I assisted in the venture capital investment of this company. But it is true that I have not seen very many venture capital investments in fintech at this year.

Lozano: Thank you, Luciana. I have to move now to Manuel – it is so great to have you with us. For us in New York and particularly Skadden, Mexico, it has been a very interesting market this year. There are some sectors that have us very concerned (as certain conditions imposed by the administration are likely to result in a deceleration of foreign investment) and there are other sectors where we can say we're really seeing significant increases in levels of foreign investment. With that, I'll open the floor for you to give us your overview.

Manuel Galicia: Thank you, Paola. What a pleasure to be with this group. I love the summary that you gave about what we thought was going to be the activity this year. I have to say that activity has been at a very good level. And in the case of Mexico, when we analyse this, we also think the world is getting very complicated. In all actuality, we are not doing that bad; we have been very active. As you mentioned, on one side you have the strategic acquisitions by the buyers who are seeing this as a good opportunity, as well as for sellers. On the other side, we have also seen some opportunistic acquisitions: companies that are facing some problems but are willing to sell.

We have been in an environment that was not exactly what we were expecting in terms of our public administration. This is an administration that does not favour investment – especially foreign investment – and despite everything, we are already at US$30 billion of foreign investment, around 40 per cent above last year.

We have been facing a government that is heavily regulating all sectors, and I think there are long-term players used to entering this type of market, especially in the energy sector. You have large companies familiar with these conditions or worse, and as a result they are very patient now getting back and getting more investment.

Originally, we thought that this year we would continue seeing a lot of activity in the fintech business and venture capital. We have seen this slow down, at least for this year, but we hope it will resume next year. We also thought there would be activity in the pharma sector. I think it was probably more active in the previous year, but in consumer goods, agroindustry and education, we have been very busy. If you look at the economic framework of Mexico, I think the government, despite everything, has been able to control inflation; we are at around 4.7 per cent in inflation. GDP is expected to be about 2.5 per cent. In terms of macroeconomics, we are doing quite well. Our foreign exchange is too strong; it's probably affecting exporters to a certain extent. But I would say our macroeconomics are looking good, especially compared to other jurisdictions.

On the political side, we are entering into an election year. Next year, we will hopefully have a woman president, which I think is very encouraging for many reasons. I think whoever becomes president will have very different goals and understanding of what must be done in Mexico. However, I think Congress will be divided. Whoever becomes the president will not have the power this administration has and I think we will have a better balance of power – that's very positive.

Looking into next year, different apparently to Argentina, we will have a lot of activity. We can see the government opening investment opportunities in infrastructure and in energy, so we are expecting an active year. You also mentioned family businesses carrying out investment abroad. Mexican families have also been very active in becoming one of the major investors in Spain and diversifying their investments.

In summary, yes, we will probably miss some of this year's projections but the outlook is very positive. I still think, and I am by nature very optimistic, that next year we will be quite active because of elections, worldwide events and Mexico's attractiveness – a direct result of nearshoring. It looks good, especially when we consider the situation worldwide. What we are facing in the scenario you explained, Paola, is not only applicable to Latin America, it is affecting many economies worldwide. Latin America has very young markets that offer new opportunities and good opportunities, so I still think it is a very attractive market.

Lozano: Thank you, Manuel. I think my one follow-up to you is on the energy market. When we are asked about Mexico, we say that despite some of the intervention by the government – which is unprecedented – we've had, as you said, very significant levels of activity so we're happy with the volume. But the energy market still has us worried in terms of the exit of some of the large players and the position of the government in connection with regulation. Do you think we've seen the worst of this situation and that it will potentially improve under a new administration?

Galicia: I honestly think that it's going to improve. The reason being we already see a lot of new activity in the energy sector. I think from a political point of view, this administration can argue they already have majority control over electricity with the acquisition of Iberdrola. At the same time they realise that if we want to take advantage of nearshoring opportunities, infrastructure will be necessary and energy will be essential. Nearshoring is something the Mexican government did not plan. It is a result of many global circumstances, mainly circumstances or strategy by the US government. And we are competing – we are not alone. That's why there is this 'friend-shoring' alternative. Our administration understands we need to put infrastructure in place and I think the government now has a way to save face and say: "Okay, we accomplished our objectives, now we can manage this." And I think there are many alternatives to enter joint venture-type arrangements that will resume activity in the energy sector. We have been very active, with five partners fully engaged in energy, which is very uncommon in Mexico. As I mentioned earlier, these types of companies are accustomed to very complicated landscapes and they are looking for opportunities, not only for next year but for the next 10 years. That's why I hope and am very happy that we will have a woman president next year. I think that it's going to be much more reasonable than today's administration. If you look at other examples of women taking office, they care. They make decisions not because of the power but because they care. I'm very optimistic about that.

Lozano: Thank you, Manuel. We're definitely very excited about the prospect of the next president of Mexico being a woman, and it does definitely look like that is going to happen.

I want to turn now to Jaime Robledo in Colombia. Colombia has been so interesting for us because there was a fear and a perception of what the worst-case scenario could be under the first non-business-friendly administration in Colombia. We have seen our investors adopt a 'wait and see' mode. But despite that general perception, the reality is that the activity has continued to occur. It has shifted though. We've seen exits, we've seen different players and we've seen different deals. I want to turn to you, Jaime, and ask you how you see the environment and maybe you can talk a little bit about some of the hostile tendencies that we've seen in Colombia that are new to many of us.

Jaime Robledo: Hi everyone. It's a pleasure to be here and it's a pleasure to be sharing this panel with all of you. Thanks Paola and Daniel and Latin Lawyer for organising. For me, it's always a challenge to be in this panel and it's because I know that everyone is expecting us to forecast M&A activity correctly, but I think it would be easier to forecast the price of oil for next year or the value of the dollar, or who is going to win the World Cup – you go around saying some things and then everything changes. Having said that, I'll take it from the top and from a macro perspective, and definitely from a global perspective, we've seen the hit of higher inflation and higher interest rates in M&A activity definitely and that has also translated in local inflation also being higher and in interest rates being higher. Obviously, that has led to a slowdown in M&A activity in Colombia as well. We believe that inflation has been curved down and is more or less under control, but the flip side of this is that this might be due to a slowdown in economic activity generally. We grew 3 per cent in the first quarter of 2023, but in the second quarter, we saw a prevalent slowdown in activity – 0.3 per cent, which has people concerned here. I think that as a general trend in Latin America over the past 10 years, possibly excluding Brazil, we saw private equity funds becoming very excited within their region, but there has been a massive retirement of a lot of private equity funds during the last three to four years, mainly because the carried interests were not attractive because of the shifts in foreign exchange. At least in Colombia, we started seeing a withdrawal of a lot of private equity funds. We thought we would see these investors replaced and also by taking advantage of the geopolitical landscape we thought we were going to see a lot of nearshoring. In Colombia, we've seen a mix of a lot of new entrants, which is strange. On the one hand, we do see some strategics who are willing to take higher risks. We're also seeing some new investors, mainly Arab sovereign funds or family offices from the Arab countries, and an interest from Chinese investors which are looking at energy assets or those types of assets which are closer to the Colombian government in, in the sense that a left-wing administration is closer to those types of investors.

Having said that, in Colombia as a general trend, what we've seen is definitely that the wait and see mode is still there. When we talk about the sort of political landscape and the geopolitical issues, we will see that the political agenda of the government has not been as successful as they thought it would be at the beginning because there's been a counterbalancing from Congress. It's helped that there's not been a massive run-off of foreign investors in Colombia. In the sense that we were hit by the very high devaluation, very shallow capital markets and very, very bad pricing of assets in the stock exchange, we have seen a number of hostile tendencies.

Obviously, the Grupo Argos, Grupo SURA, Nutresa, Gilinski and IHC saga is one of them, but we've also seen non-solicited offers for Éxito, for instance; and we've heard rumours about other types of investors trying to protect their investments by either implementing local poison pills, or a re-domiciliation of their listings - trying to move them to New York or Sao Paulo. Éxito did it, and I would say that a number of our listed companies, of which there are not many left because our stock exchange is very shallow now, will follow that trend and will try to move and redomicile their listings into a more liquid market.

There's not a very logical order to a lot of the things that happen in the landscape; some investors that have more appetite for risk and others don't, so it is difficult to talk about general trends.

Lozano: That's helpful, Jaime, just one quick follow up for you. I think one of the biggest concerns that we have seen from the outside is precisely how shallow the capital markets are. In terms of the stock exchange, the number of companies that trade and the volume at which they're trading seems to be at a historical low. The concern is how much does that impact M&A activity and if that could be expected to change in the near future?

Robledo: In general terms, I wouldn't say it impacts the whole world of M&A activity, but it definitely opens up opportunities for a number of potential transactions that we have not seen in Colombia and in Latin America generally. There could also be an open space for activism. I still think that some of the foreign activists are very weary or cautious with respect to the legal and regulatory landscape in Colombia and they think that their minority shareholder protections are not sufficiently developed to undertake important activism. On the other hand, the lack of liquidity in itself is a deterrent for activism because they can come in, but they don't know exactly how they're going to go out. Locally, we do see a couple of people looking at the possibility of activism, trying to optimise a number of listed assets. One of the things that is an indirect consequence of the low valuations is that management teams are starting to look at the pool of assets and saying: maybe it is not efficient to keep this asset here, maybe I'll go out and sell it, or maybe I'll monetise it. Eventually this may foster M&A activity. You've seen that SURA has come out to sell their operations in Sao Paolo, their operations in Argentina. They're trying to reshuffle all of their assets and maybe look at more efficient ways to allocate their capital and return it to shareholders. I do think it's an alarm, a wake-up call for management teams, especially in those companies in which the controlling shareholder is not as prevalent. In the case of SURA and Nutresa it was clear that they had a huge float, but there are still some companies that, although they are being controlled, they have a 30 per cent to 40 per cent float out there and there are a number of ways, and you could start affecting their operations just by intervening actively into their shareholding base. That has triggered the imagination of management teams, and they're looking at other ways of doing things. For instance, the Cementos Argos transaction was basically that – a way to protect themselves from a potential takeover of one of their most valuable assets that wasn't reflected at all in the stock price. When you compare the price that was paid for the US asset in the merger, the implied valuation - and this is a deal that was announced last week to a panellist for context – it's higher than the valuation of the whole company in the Colombian stock exchange. This gives you a sense of differences in valuation and the real fundamental value that is in these companies that is not being appreciated by the market.

Lozano: Correct. That's why I think it's so important that practitioners continue to do what they can to strengthen the local stock exchange, because I think we will recapture value for all market participants if we do that.

Without further ado, I want to turn to you Iván. I wanted to leave you last because you, as we do in the US, have the overview from outside. I wanted partly to test whether you're seeing a similar phenomenon that we are, which is good but it worries us. That is, a lot of the deal activity from the US into Latin America has been in the form of exits of large players in the region diversifying risk, reducing exposure and then coming back to redeploy capital (potentially in the domestic markets) or to strengthen the coffers for what may be bad times. I'll let you give us the overview of how you see the landscape from Spain and Europe for Latin American M&A.

Iván Delgado: Thank you Paola for inviting me to this amazing panel. It's great to be with you to share my views. I'm going to be very brief, and even though you have started with my third point – which is how we see the investments from Latin America into Europe – I will start with bad news: Europe is not going anywhere. The European Commission just announced today that Europe is going to grow between 0.0 per cent and 0.8 per cent in 2023. That means nothing for Europe. We are suffering the same political instability as Latin America and we are also suffering not only inflation and interest rates, but also from the Ukrainian invasion. The investors are looking for places for investing, so that's the bad news.

The good news is that European investors still have money, they still want to invest and to grow their businesses and they are still willing to go to other regions like Latin America knowing that they have to take more risks. We are seeing two types of investors investing in these regions: the first are the strategics, which you all have mentioned, looking to grow in regions like Latin America where they may find opportunities and good assets for the future. Second, the private equities. For example, and this is a real case is that I've been looking into, private equities that already have assets in certain sectors like energy, or infrastructure, where they already have assets in in Europe but they want to grow their businesses, they are looking for build-ups in Latin America. That's one trend that we have seen from Europe.

Another one is the private equities that, since they have a lot of money, they are willing to invest in Latin America knowing that they will have to explain to their investors that those investments are going to take longer to yield capital. This is still good news for Latin America.

The third is that we are seeing a lot of Mexican family offices, but noy only Mexicans but also family offices from Colombia and Chile, coming into Europe. Not only they do like the currency, having their assets or holdings in Euros, but they also like to diversify and to invest in Europe instead of the US where they used to look.

Lozano: That's great. One quick follow up, Iván. I think the fears that the global analysts had about the war in Ukraine tampering with activity in the Americas has not materialised. As tragic and horrendous as the war in Ukraine has been, there's no excuse for that, but we haven't seen from New York that it has actually significantly impacted activity. Is this something that has impacted M&A activity in Spain and Europe?

Delgado: Of course. Everybody's looking into the invasion and it's impacting everything, not only financing but businesses as well. Investors used to look into Europe as a whole and now they have to look into certain countries and not others. I'm not talking just about Russia or Ukraine, the two directly affected by the invasion, but Poland and other countries around the war or the invasion. That is one of the reasons that Europe is not going anywhere; when you look at where to invest in Europe, suddenly you realise that only a few countries are available if you want your investment to be safe. It is affecting the M&A activity for sure.

Lozano: Yes, that is a concern because as I said, we haven't seen it here but the more it impacts the rest of the world, eventually it will hit Latin America. We've covered a lot of the global geopolitical issues, but there are a couple of topics that we should go back to, one being the US-China relationship or lack thereof, and how that may impact our jurisdictions. And the other one is nearshoring. Let me start with Luciana on this one. Luciana, I did read something that surprised me – the theory in the US has been that with retreating investments because corporates were doubtful and hesitant in an inflationary environment and a potential recession (that didn't materialise, but it was a concern) that China would significantly overtake the volume of investments, including for M&A activity. I recently saw something that said that, to the contrary, in Brazil, Chinese investments have not grown. Can we talk a little bit about the impact of that in Brazilian M&A?

Tornovsky: I certainly agree that geopolitical events abroad can affect M&A deals in Brazil. Brazil is an emerging market, as you know, and global events can either attract or discourage foreign investments and M&A activity in the country. For example, we've talked about the Ukraine war. And it's very sad, of course, but for us it has brought some benefits, it's been good for the Brazilian agribusiness sector. Ukraine is known as the breadbasket of Europe due to its huge agricultural production, particularly in grains. The war has harmed Ukraine's agricultural sector and caused a lot of uncertainty in the global grain market. For Brazilian agribusiness, which is already a major player in the global agricultural trade, I think we could take the opportunity to increase the Brazilian market share. Brazil is one of the world's largest exporters of agricultural commodities, including corn, soybeans and beef. Where Ukraine faces challenges in meeting global demand, the Brazilian agribusiness can step in and fill the gap, supplying commodities to countries that traditionally rely on Ukrainian exports.

Regarding what you said about China and the US and the trade conflict between the two countries, it also affects M&A deals in Brazil. Brazil is a very important player in commodities, so any problems between China and the US can indirectly affect M&A activity in Brazil. Both China and the US may seek alternative markets in which to source goods and services, and Brazilian companies can take advantage of that to create opportunities for M&A activity in the sectors that are deemed important.

Yesterday I was reading an article in a Brazilian newspaper that said Brazil could gain US$8 billion per year in new exports, according to research by the Inter-American Development Bank, due to the attraction of new companies to Brazil through nearshoring. While this is an important amount, it is much less than what is expected for Mexico: approximately US$35.2 billion per year. Brazil will see the second largest influx of US dollars in Latin America as a result of the nearshoring conditions, with Argentina in third place, Colombia the fourth and Chile the fifth.

Brazil has a strategic location – it can attend to Latin America, the south of Africa and the north of Europe. Another thing that is very good in terms of products is that Brazil has a very big renewable energy matrix, bigger than Mexico's. So although Mexico has the greater advantage of being closer to the US, Brazil is better in terms of renewable energy. According to this research, Brazil has bigger potential in the automotive sector – we could replace 30 per cent of our current exports of spare parts from China for instance, and it would add US$1 billion to this sector. In the last two years, we had four Chinese automotive companies come to Brazil with a total investment of more than 13 billion reals, which is estimated to reach over 20 billion reals. These companies have projects to produce hybrid and electric cars in Brazil. The expansion of Chinese businesses shows which countries are deemed strategic for China, such as South Africa and Brazil. Brazil is a very strong player in renewable energy, particularly in hydro, solar and wind power, and international geopolitical events can have a huge impact on M&A transactions in Brazil, influencing both inbound and outbound investment activities.

Lozano: Thank you, Luciana. Let me turn to Jaime now. Based on this data on nearshoring, I think there is potential for Colombia. We haven't seen it materialise just yet, even though the talent is there and the market is there. I'm not sure if this is because of concerns about the certainty for investment (which I don't think is as much of a concern for Chinese or other Asian investors) or if there is another reason that we're missing. If you look at the rankings, we're clearly talking about the size of market – they almost exactly match the order of Brazil, Mexico, Argentina, Colombia and then Chile, which is a larger market in certain aspects, but not in terms of labour force. With that, can you tell us how you see these other specific geopolitical, international forces that may impact M&A in Colombia?

Robledo: I think that in the case of Colombia, as you mentioned, there were a number of factors that would have placed Colombia in an enviable position for nearshoring. When the China-US relationship started deteriorating and the US shifted towards nearshoring, we started seeing that Colombia would have a great potential. However, some things have played down that potential. Obviously, the local political landscape: people are still very wary about investing in Colombia because of the non-friendly government attitude towards business. That's one thing. The other thing is we still lack substantial infrastructure and industry nearshoring requires a lot of infrastructure. Services nearshoring specifically – which has great potential in Colombia – is affected by potential reforms; the labour reform might eventually impact a lot of those types of projects.

People are still waiting to see whether that reform is going to pass. I believe it will not. Given the actual circumstances of the country people have shifted away from the government – when it first came to power everyone was saying, we'll try to form a coalition, we'll try to work with this government to that are being proposed, but with a shift towards the centre to try and work our way towards becoming a more equitable country. However, what happened was then when the government proposed the reforms, they came with very radical drafts that had not been reconciled with any of the central parties. So everybody in those partis said: forget it, we're not going to pass those laws. What we've seen is a stalemate in Congress, in which the government hasn't been able to pass any of the reforms that it was supposed to have passed by now – tax, labour, education, pensions and health. It has only passed tax and a very watered-down version of it.

Nearshoring in Colombia is being affected by three factors. The first one is uncertainty with this government. Nobody is willing to accept, nor is really convinced that the government will not be able to pass some of these of those reforms. But they're not as pessimistic as to exit Colombia. Secondly, infrastructure is still an issue, especially in what we call industry services nearshoring. There is one additional element that you might not be able to see from abroad yet, but that might convert into a very strong deterrent, and it is that the current government is turning a blind eye to the deterioration of the security situation in some parts of the country. The Mexican cartels have managed to take over the southwest of our country together with the local cartels and it's been escalating. And the government hasn't been at all receptive to requests from local governors; so that is something that concerns us a lot. When people come here to try to look at some of the potential nearshoring opportunities near Buenaventura (one of the most important ports), they immediately cross it off their list because there's no security situation here that they can offer to their board. Those are the reasons why there's still a lot of paralysis in respect of those projects.

Lozano: So many things to say about Colombia. It has so much potential that should materialise. But I completely agree with you, Jaime. I think there's a wait and see attitude that is different from what we see in other countries because here, as you said, it is the elected government with a vast majority and the hope for a coalition that could result in better conditions for economic growth and legal certainty; now with the coalition broken, the popularity rate falling off the charts and these reforms looming, the concerns are very significant. And you're right, I think some foreign investors that haven't yet entered the Colombian market are doing deep diligence on these matters and the ones that are already operating in Colombia have definitely mentioned their increased hesitation to us.

Let me turn to Iván. I don't know if Europe feels the same way about Latin America. My sense from here is that some of the hype that we had anticipated from Chinese investments abroad has not materialised because China has its own internal problems and they're deploying less capital than we had expected. I'm not sure if you see it the same way, Iván?

Delgado: Yes, of course. When we faced Covid, we all – the European Union as well –approved the FDI regulations, which basically affected the Chinese investments. We all started to talk about deglobalisation. Since then the natural place to think about nearshoring opportunity was Eastern Europe, but then the Ukraine war started so some investors started to think about the north of Africa for nearshoring and others have been looking into Latin America.

The issue we are seeing is that some investors are changing their plans: instead of buying a company or assets in Brazil, Argentina, Colombia or Mexico, they are thinking more about joint ventures and minority stakes. They don't want to take on a lot of risk because they have already suffered. We have seen a shift in the way that European investors, because of the Ukraine war again, are looking into this nearshoring scenario. Talking about Chinese investors, I don't see them being very active because of the main issues that you were discussing before, Paola.

Lozano: Correct. As Manuel has said, some of the issues for each of the countries represented in this panel are issues that pretty much every country around the world is facing. China has its own issues with supply and demand, the deployment of capital, and the investment priorities. For whatever it's worth, the policies that the US government has implemented have had significant negative impact on Chinese investments. If you look at the level of enforcement of existing rules that have the potential to reduce US exposure to Chinese controlled assets, goods and services, and therefore transactions with Chinese parties, the impact has been significant.

Manuel, let me turn to you now, because I think that just like Brazil, Mexico has been successfully capitalising on nearshoring opportunities and obviously with Mexico, we've seen that for good trends and bad trends. Mexico's proximity to the United States gives it a unique position when there's this type of opportunity, as it does when there are issues. When the US economy goes into a recession, Mexico falls before the other Latin American jurisdictions, but when there's an opportunity for deployment of capital and redirection of investment, Mexico stands to benefit first. So, tell us a little bit about how you're seeing this.

Galicia: Nearshoring is not the result of a strategic decision made by Mexico, but at the same time Mexico has been working for the past 30 years on entering into free trade agreements, and building important infrastructure. I'm glad to listen to Luciana and those forecasts – I think they are also in accordance with what we read last year in the Morgan Stanley and the Goldman Sachs reports. They foresee Mexico, together with India and Saudi Arabia, to be the countries that will have economic growth over the next five years – I hope that's accurate! There are still, a lot of challenges, of course. I think for nearshoring to really happen the way everybody's expecting, we need to work in Mexico. Similarly, what Jaime mentioned, the rule of law is very relevant, as is infrastructure in electricity and security. I think those are the three areas where Mexico needs to work on and understand we are not alone, that we are competing with other countries even if they are not located as close to the US. I also hope we start to understand, like in Brazil, the domestic market is relevant. One strategy is to understand that there are major industrial groups in Mexico that are probably not so well known but they are very strong. In our case, we are working very hard on getting closer to those industrial groups. As in Brazil, governments can change but the economy continues because of the private sector. I think that the Mexican private sector has also grown to become very institutionalised, which is also helping us to remain active in the M&A market with more strategic investments.

As to your question regarding China, I think that Mexico has not received as many investments from China as other Latin American countries, probably because the Chinese are afraid of the US market. If you compare what has happened in Brazil, Peru, Venezuela and some other countries, we haven't received that much. However, in this past year, we've seen more and more Chinese investments, even though they are facing a lot of internal problems. But in terms of the level of investment they require to enter the Mexican market, we see them becoming very active and making small acquisitions because they are getting ready to see whether they can also supply the US market. We see an expansion on Chinese investment. We also saw last year's and this year's investment in infrastructure, but I don't foresee our government will have the opportunity to attract as much Chinese investment as we expected. I think what the US is doing – funding and supporting companies in the US and Mexico to export to the US – will become more relevant. The Inflation Reduction Act, which is not only related to inflation, sets out many initiatives to expand business towards the US so I don't foresee that Mexico will be depending on Chinese investment. Clearly our major partners are the US and Canada and at least for the next five to 10 years, it will remain the same.

Lozano: You're right, Manuel, the market between the US, Canada and Mexico together with the international treaties and some of the incentives that the US government has put in place are meaningful. I would like to emphasise something Jaime said, which is the potential impact of an aggressive labour report reform in a place like Colombia that may have deep dampening effects in nearshoring. I think part of what makes Mexico attractive is that while there is a need for more redistribution of wealth and opportunities for all classes, exceedingly costly labour is definitely a deterrent for foreign investment for M&A. Mexico is still very attractive in those terms to North American corporations. I think about the potential Mexico has for nearshoring and compare it to how the proposed labour reform in Colombia may impact that. I feel the need to turn to Lao and Argentina, which is a complex market because of its historically comparative high labour costs, but then there's the favourable exchange rate, so it's anybody's guess. Then, you compound that with inflation and that's an impossible calculation. How do you see near shoring potential and all these other trends impacting Argentina specifically?

Olmos: It is a hard one because we are in the middle of a debate among all the probable candidates for the next presidency of Argentina and it seems that there is a common understanding that labour reform is well overdue. Whether that is feasible next year or not really depends on the elections results – the percentage – but at least two of out of the three candidates are aggressively pushing for that reform to take place.

When it comes to the cost, when it comes to logistics everything that is moved by track is significantly costly for any company in Argentina. I have to distinguish this because when it comes to services and you turn the peso cost into US dollars, actually Argentina has a very significant opportunity because we have, in hard currency, very low cost for human capital. In LatAm, we are known to be very, very high when it comes to education rankings, we have a very significant English level across the population, which is an advantage, and we have the same culture and we have this because of resilience. Argentinians are forced to deal with problems so when it comes to choosing a nearshoring jurisdiction for services, certainly Argentina is a great option.

Of course, inflation and foreign exchange regulations restricting dividends moving out the country is a deterrent, but we would see that changing eventually in the next two years. But we have the right attitude. We share the same time zone with the United States, which is our largest market – although China has increasing growth in terms of trade. Of course, China is trying to do as much as it can in tapping available options when it comes to resources and is lately even playing harder when it comes to negotiations with the IMF, which for Argentina is always a trouble.

But we shall see what the future has in store for us. Whenever Brazil benefits from this opportunity, we do as well because we are very close trade partners. This year we couldn't seize the opportunity in the agricultural sector because we have a significant drought with US$20 billion reduction in the output of a raw commodities so that was very, very important for us. But it seems that La Niña is going out and El Niño is coming in, so we should have better opportunities next year.

Lozano: So let's very quickly turn to one last topic before we turn to ESG – and that is deal financing overall. We've mentioned financing in passing, but the conundrum of many corporations is that they need to maintain the strength of their balance sheets and they fear that doing M&A may weaken – in the case of acquirers – their balance sheets. In the case of sellers, their concern is they are not getting the pricing they want and so again, in trying to strengthen their balance sheets, they may be deterred from doing M&A.

While private equity funds seem to have significant amounts of dry powder they have to deploy, we see a slow-down. The banking sector in the United States was also very slow to lend in the first nine months of this year. As I mentioned before, there were a couple of failures that instilled fear in US regulators (and therefore bankers) and the system became very conservative in terms of acquisition financing and lending generally. So I would like to explore how you think availability of financing is shaping up today, in terms of whether there is financing available for the deals that you want to do, that you and your clients are trying to take to market – and whether the trends are shifting back again from private equity to bank finance or other more creative sources of financing. Let's go to Brazil first.

Tornovsky: This first quarter was very difficult for many deals in Brazil. We saw a big decrease compared to last year's, which were amazing. We had almost US$43 billion in terms of M&A transactions in 2022 and 2021, and the reduction for this year was to US$36 billion. So there was a big impact on M&A. The main reason was, as you said, high inflation and very high interest rates. I think all investors were very concerned about what was going on and the change of president that we had at the beginning of the year was also very important to this uncertainty in the market.

Those uncertainties can always result in slowdown in M&A activities because investors seem to delay or hold off on making investments or acquisition decisions until the political situation gets back to normal. Considering the scenario of Brazil, I think Lula is someone that everybody knows already because we had him from 2003 until 2010. I was in New York in 2003 when Lula was elected for the first time. He was a left-wing president and everybody was asking me what would happen in Brazil – everybody was very worried.

But at the end of the day, Lula's administration was not that bad for the country in terms of M&A deals. His main agenda was to promote economic growth, to reduce poverty and to increase social inclusion. He wanted to implement all these policies and to protect domestic industry and national interests, but he was also very worried about and introduced stronger regulations on foreign investments. During his tenure from 2003 until 2010, M&A transactions involving foreign companies faced increased scrutiny and regulatory hurdles, particularly in sectors deemed strategic and sensitive to national security.

But Lula's government implemented measures to promote domestic ownership and control over key industries, such as oil and gas, mining and telecommunications, and this led to the creation of state-owned companies and the strengthening of regulations to ensure Brazilian control over its strategic assets.

But on the other hand, Lula's government pursued policies to attract foreign investments and promote international trade, so he was trying to simplify bureaucracy – Brazil has a lot of bureaucracy – and to enhance Brazil's image as an investment hub and to improve the business environment. So these measures had the purpose of stimulating economic growth and creating opportunities for both domestic and foreign investors, which contributed to the increase of M&A activities.

At the end of the day, the impact of Lula's government on M&A activity was a mix of opportunities and challenges, because while efforts to stimulate domestic industries and protect national interests sometimes created hurdles for foreign investors, initiatives to attract foreign investment and promote economic growth provided opportunities for M&A transactions.

At the beginning of 2023, with the return of Lula as president, investors were initially very worried about the country's political and economic situation, with high inflation and very high interest rates, so it caused a lot of uncertainty. We saw a decrease in the number of the IPOs and M&As in Brazil, so the capital market was almost nothing – we had no IPOs at the beginning of the year. But the market and investors already know Lula, so in my opinion, it is totally different this time compared to 2003. Lula has been pragmatic in his decision-making process. He is governing with the support of the conservative right wing to approve the economic agenda; the famous tax reform that we have been talking about for a long time is in the final stage of being approved. I think the market is also giving a vote of trust to Lula's finance minister Fernando Adadi after a period of uncertainty.

Lula is trying to attract more investments to Brazil now. Yesterday, Brazil, the United States and India launched the Global Biofuels Alliance, the GBA. This initiative has the purpose of promoting the production and use of biofuels – especially ethanol – as an alternative energy source for transportation, which is less polluting than fossil fuels and these three countries are the major players in producing ethanol worldwide.

Also, one advantage of Lula's government is the independence of the Central Bank, which is very important for our democracy and also the very good relationship Lula has with the Supreme Court and other superior courts, which unfortunately our former president did not have. So this is good for the country and our democracy.

Lozano: Quick question, Luciana. I am not sure if this information is readily available – do we know if BNDES is actively financing deals in 2023 like it used to do in the past?

As I think again about financing in the context of this set-up that you have told us you have right now with Lula in Brazil, one of the things that comes to mind is that Brazil used to be a place where it was less relevant what was happening in the international financing markets because BNDES was deploying a significant amount of cash into M&A activity. Is that still the case? Is there information about that?

Tornovsky: I think BNDES continues to finance deals. The bank has recently published that it disbursed 40.6 billion reals in the first semester of this year, reflecting an increase of 21.6 per cent in relation to the same period in 2022. With the softening of the Selic rate, the expectation is to have an increment in the deals as a whole, including the ones with BNDES. For instance, the bank informed last week that it will invest up to 638.5 million reals in start-ups and medium-sized companies, through investments funds.

Lozano: Iván, let me turn to you again. Just on financing of transactions in Europe and in the deals that you do that are cross-border – often involving not only Spain and Latin America but also New York or Delaware, have you seen the impact of less availability of financing.

Delgado: Absolutely. We have seen less banking finance in the last six months. However, we are lucky because we have seen a trend and also a lot of transactions being financed directly by direct lenders. That is a trend in Europe and I think it is spreading to other regions. We have seen private or direct lenders replacing banking finance – of course, at different prices and asking for different guarantees, but those lenders have been more active than we were expecting at the beginning of the year.

The second issue that we have seen in Europe is that the European Union launched a huge package of funds for companies, which have allowed them not only to carry on their day-to-day business but also to go ahead and do a few transactions, M&A acquisitions, in the market.

So we have those two recourses or sources of funds that have been replacing banking financing, which is why we are happy.

Lozano: That's great and that's why I wanted to go there, because I think for all of us practitioners in the complex M&A market, when the deals get more complex, we come in as more necessary assets for the companies and the bankers. We have seen a real need for significant structuring in the financing of transactions and it may come in many ways, as you said. I think we have seen funding from all sorts of funds, not only private equity funds that have a lot of white powder, but sovereign funds that we had never seen before financing LatAm deals. So, Jaime, let's talk a little bit about that, and in passing mention whether there is local lending, because I am concerned about seeing Colombia so dependent on foreign lending on the bank side.

Robledo: Let's start from the top. I think that financing from traditional sources is still available, but the interest rates are very hot. So in that sense it's like a false availability – they are available, there is liquidity, the banks have the monies and the funds to lend out, but again, the interest rates are high and there are a number of complexities when foreign investors come into the country. Specifically, if they are taking the debt in dollars, there is still the foreign exchange issue. As you saw, the Colombian peso revaluated versus the dollar in 20 per cent in the first six months of this year. It was crazy because we had a political situation which was not desirable, but nonetheless the peso was revaluating. The more the government was losing its popularity, the more the peso appreciated versus the dollar. It was crazy – nobody was able to actually forecast what was happening. So there are a number of variables that are very difficult to reconcile between lenders and borrowers.

The sovereign funds that we've seen basically lending into some of the transactions here are mostly the Arab sovereign funds or family offices. At the end of the day, one might say that some of them are the same, especially when you talk about Abu Dhabi – the Bin Zayed family is the controller of Mubadala and at the same time controlling the First Abu Dhabi Bank, but they act with different hats. When they come with Mubadala or if they come with ADIA they're a sovereign fund, if they come through IHC it's the private arm of the family.

But at the end of the day they manage, just like a family office that manages around US$20 to 30 billion, which is completely at their disposal, without accounting for the fact that IHC alone has a market cap of around US$200 billion in the Abu Dhabi Stock Exchange. But when you see that, they have very cheap money not only in Colombia, we are also seeing the Saudis starting to look at assets in some other parts. In Spain they just bought in 9.9 per cent of Telefonica.

We do see those types of financings, but they are for very specific purposes with respect to relationships that they've had or they've been having for a long time, so they are not really off-the-shelf financing that you can just ask for. You have to develop a very specific, long-term relationship with them and go and present specific opportunities. When you do that, you might find that they are willing. The problem for a Colombian transaction or operation is that it is competing with transactions all over the world. The Blackstones, the BlackRocks, the KKRs of the world are going to these guys to ask them for financing or to participate in some of their funds. They've done a pretty good job, these funds, these family offices, at heightening their status and they are now world-class lenders or world-class financers – that wouldn't have happened 10 years ago. You wouldn't have seen a BlackRock or a KKR accessing funds of an Arab country. Now we do see that, and it is something that is more common nowadays.

So to your question, we do see that, but there are a couple of things that are not necessarily as common as it would be. Tickets for these guys have to be really high, above US$500 million, so it's not the day-to-day' M&A that you see in Colombia. Second, they are for very specific opportunities and that's not only ticket-wise but also relationship-wise. They are obviously interested in certain businesses that would diversify their oil and gas economy – agribusiness, food businesses, retail businesses, financial services. But commoditised businesses, they are not as interested. With respect to local banks, they have liquidity and money, but again the rates are really high and there's still a mismatch between the foreign exchange rate and interest rates so it's difficult to have some of those deals financed more from a practical perspective than an availability perspective.

It's not something that has been very common in Colombia, but when you talked about BNDES, we have struggled as a country to actually create a development bank that is able to finance opportunities in M&A – we have struggled with that, and we keep on struggling. With this new government, there is not going to be a difference. But there would have been a great opportunity to have developed a good and strong development bank with a strong balance sheet for a number of opportunities and that has not happened. So, it's still a challenge.

Lozano: Two things come to mind that are very important. One, for the practitioners. The rest of the M&A Guide is very specific as to terms in dealmaking. This roundtable is more a macroeconomic debate, a circumstantial description and an understanding at a very high level of all the pros and cons, as well as the positive and negative influences, that we face in a particular moment to do M&A transactions. But just to make it relevant for the rest of the M&A Guide, one thing I'll say is that the fact that there is so much of this financing coming from private equity funds – from sovereign funds – that as Jaime said have a lot of leverage now, means that in our transaction documents, this financing looks like equity for the most part, it does not look like traditional deal financing. It's not acquisition financing like we have known, cookie-cutter, for decades. It is complex structured equity financing with teeth that often causes buyers and sellers to have to negotiate with a third party with significant leverage. It is worth mentioning that we don't always have full visibility on the true impact of the terms of the financing coming from these alternative sources and how they may be affecting the M&A transaction at its core. They may in some cases be calling the shots.

The other thing that Jaime said that is very interesting and is a good transition to Manuel on this topic, is the size of ticket. There is financing available but some of the cash-rich funds that are available are only interested in very large tickets. We have seen, even in the United States, the size of the M&A deal value has become smaller in 2023 than it was in 2022. There is a debate among practitioners and there is some data that shows that it may still be stronger than pre-pandemic levels, but it's definitely softer than last year.

So turning to size of ticket, Manuel, with respect to financing in Mexico, the availability of funds from the large players that have historically liked their exposure to Mexico, do you think it's still there, have the large emirate equity funds with historical exposure to Mexico continued their investment pace or are they neutral or pulling out?

Galicia: I think part of the problem in this discussion is when we get the perspective of what is happening in more mature markets like the United States or Europe. When you analyse what is happening in Mexico – and I will talk about our own experience today – probably the three larger transactions we are working on are led by private equity funds What we were expecting last year was the reduction of private equity participation in in our market, of course it could be larger, but I think it remains still very active and larger transactions with large tickets are still led by private equity funds. Like in other jurisdictions, liquidity is there, it is somehow available, but interest rates make it very complicated. Nevertheless, for example, right now we are working on the acquisition finance of Iberdrola, it is a US$6 billion transaction and local banks have been very active. So we are having all these extreme sizes of transactions, but recall what I was trying to say at the beginning – everything is relative. In our domestic markets, there might be only 10 transactions like this, so there is still room for private equity and local banks to fund this type of large transaction. I think there is also liquidity for some strategical acquisitions of lower tickets of Mexican companies that are making acquisitions from a strategical point of view. It is also very sad to see, as you mentioned earlier Paola, the fact that we don't see IPOs. We see capital market activity that could also be another source of funding. This year in Mexico there has only been one IPO – last year, none. That is a dramatic drop in the market compared to others and I think it would be good for our economy to have other sources of finance.

I additionally think, as Iván was mentioning, we see activity on funds through direct lenders that are supporting, also some private equities doing mezzanine types of lending so there is still activity in the M&A sector, but of course it's becoming harder. With those types of interest, it would be nicer to have more capability to finance acquisitions through the banking sector, but there is still some activity.

Lozano: That is very encouraging Manuel and consistent with what we've seen, and that is that Mexico continues to be a market for which the large funds have a lot of appetite. I think part of it is obviously, as you said, there are still a lot of companies that can mature and provide a very significant rate of return, which is aided by the size of the market. It's just that if you are able to get into an industry where penetration is low, despite some of the other issues and headwinds that we have discussed, the potential for a high rate of return in a horizon of four to seven years is high. By the way, we used to say that private equity exit horizons were three to five years and I believe we are now seeing more five to seven years for successful exists, if not longer.

Turning now to Argentina, I fear that this is an absolutely unique market and the difficulties are beyond comparison.

Olmos: You seldom see acquisition finance, even fewer than in Mexico, as Manuel indicated. You see some direct lending from family offices for local currency M&A – they are sitting on a pile of money so they're using it as direct lenders and they're seizing the opportunity that banks are tied up with purchasing public bonds so they are not lending at all. So there's an opportunity there and some mezzanine when it comes to venture private equity money transactions. But it's really a different jurisdiction compared to Brazil and Colombia.

Lozano: One thing that I should have said before (and sadly we don't have anybody from Chile or Peru in the panel), is that there are also other jurisdictions, especially Chile, where there is significant cash held by the larger family offices and corporate enterprises that were desperate to diversify. We've seen them financing transactions, through equity again. Those are deals that we like because they are very complex – sometimes converts, sometimes forms of creative earn-outs – financed by family offices in Chile, Peru, Colombia and Mexico. And, of course Brazilians have been investing throughout Latin America for a long time. So the hope I have for LatAm markets is that that lack of traditional bank financing is going to continue to be carried by liquidity of wealthy family offices and conglomerates around the region. Right now, exchange controls make it difficult in Argentina, but hopefully with some flexibility from the future administration we'll see that.

ESG is a topic that could give us a whole three hours of discussion. Each of the 'E', 'S' and the 'G' would need an hour each by each country. But what I am going to ask is that each of you just tell us if it is true with respect to 2023 and the prospects and the hype that was raised has materialised – whether it is environmental, social or governance and compliance – meaning whether law firms are investing a significant amount of their time in one, two or three of those aspects of dealmaking.

Olmos: In Argentina lately, tied to M&A of course, what we've seen is more interesting carbon reduction projects and we are actually seeing electric companies buying forest entities to launch actual carbon reduction projects, which is very unusual. So they are really putting effort in turning theory into facts and now we see an interest in pushing that type of transaction. We are getting familiar with Read projects, with AAR and we are happy to see that moving on. There have been a couple of transactions already and it seems this is a trend moving forward.

Tornovsky: In Brazil we have been seeing a growing concern with environmental and sustainability issues in M&A transactions. I think investors are taking ESG criteria more into consideration in their decision-making process, which has led to an increase in deals related to clean technology, renewable energy and sustainable agriculture. Both investors and Brazilian companies are focusing more on ESG factors to prepare for investments. Brazilian companies are adopting sustainable practices to reduce environmental risks, as Lao was saying, to minimise their carbon footprint. This includes implementing energy-efficient technologies, investing in renewable energy sources and adopting sustainable supply-chain practices. Companies are also giving priority to initiatives to protect biodiversity and reduce deforestation, especially in industries like agriculture and mining.

Brazilian companies are more concerned with social responsibility, which includes supporting education and healthcare programmes and promoting diversity and inclusion programmes in companies and ensuring fair labour practices. They are improving corporate governance practices by increasing diversity in the boards and promoting full-disclosure practices. Companies are also working to make their corporate governance in accordance with international best practice to increase investor confidence and attract responsible investment. So Brazilian companies are increasingly providing ESG-related information to investors and stakeholders. They are adopting frameworks such as global reporting initiatives, the GRI and Sustainability Accounting Standards Board guidelines to standardise and improve the quality of their ESG reporting. This enables investors to assess and compare companies based on their ESG performance. So they are recognising the importance of ESG factors in attracting investment and they are also proactively integrating ESG criteria into their strategic decision-making process, including investment planning and risk management.

Another topic, Paola, that is important is about green-shoring – this is another trend where Brazil could have some advantage, I hope. Companies should have more sustainable supply chains and establish themselves in better locations. So if green-shoring flourishes, I think Brazil could benefit from having a large supply of solar, wind and hydropower, which could be used to manufacture green hydrogen.

In addition, if the tax reform is finally approved by the Senate and the country improves its infrastructure, as many of us said before, Brazil could become a hub for the production of sustainable goods, as Brazil has a relatively good competitive position to attract investment due to the lack of military conflict. It has a familiar business environment for Western countries, although complex and a clean energy matrix; so according to some experts Brazil has big chances of expanding clean energy production and can attract energy-intensive industrial processes.

In summary, Brazilian companies are recognising the importance of ESG factors in attracting investments and mitigating risks. They are adopting sustainable practices, giving attention to social responsibility, increasing best-practice governance and improving ESG reporting.

In the firm, our ESG practice has been very busy in terms of helping clients to prepare for this new world. Regarding ESG due diligence, for instance, we have been requested to do ESG due diligence in some M&A and capital market deals. I'm curious to know if someone has seen that in their firms.

I have not worked on a deal where my client, either investor or buyer, has asked us to do a kind of ESG due diligence. No we have not done that yet – I'm curious to know if someone has seen that in their firms.

Lozano: That is interesting. I will turn to Iván because I saw him raise his hand, but I will say quickly that from a US perspective, there are some publicly held companies and regulated entities that absolutely have to show their focus and attention to ESG in tangible ways. Even if it may be "just to check the box", they have to do it because for publicly traded companies there is a standard and there are reporting requirements with agency oversight and there will be negative effects if they apply lower standards in LatAm than are required by their operations or regulators in the United States.

Galicia: But private equity funds are also looking to that as one of the conditions to invest. Sorry for interrupting, but we have seen due diligence processes that focus on ESG matters for that reason. One of the financing sources of these transactions are funds so this is becoming a very relevant issue and something we will see increase. I think covid on one side is helping highlight how relevant this topic is, and so is everything else we are experiencing – the high temperatures in Europe, severe floods – this is for real. If you look at how insurance companies are reacting, because they are the first ones measuring risk, this is becoming a relevant business issue for risktakers like insurance companies for lending activities. This is here to stay, and I think companies need to see this more as a business opportunity to be in a better position to take advantage of doing business. I think that there is a big, big change.

We are also very active in advising companies; still, sometimes it is a little bit intangible, but I always recall the time we started corporate governance with companies and tried to convince everybody this was relevant for them to get access to financing. Today, this is something you don't need to teach anybody. So I think this is also an educational process similar to the one we had with corporate governance in general for the securities market. And I think we are getting there.

Lozano: I am so glad, Manuel, that you jumped in because that's exactly right. Private equity funds do have their policies that require them to continue to monitor and improve all aspects of ESG policies.

Delgado: I just want to add that I think Europe is ahead of other regions in ESG; the European Union has been very active and we are still trying to understand a few things that are included in the ESG regulation like taxonomy for example, which is something that companies have to comply with according to agency regulations. However, I already see ESG affecting M&A deals. We are looking into that when we carry out due diligence. We are also seeing that ESG may impact the valuation of a company that is in compliance with EU regulations. We have seen a lot of regulatory pressure coming from the European Union again. And as Manuel was saying, we have seen more and more difficulties with access to capital if companies do not comply with ESG regulations. I think this is something that will probably not change our job as lawyers, but that we have to factor in when advising the client on a transaction.

Robledo: From the Colombian perspective, definitely we're seeing a focus on ESG and I would say that this government has put a very special emphasis on state-owned companies to be very, very aware and conscious of environmental matters and especially social matters.

One of the things that has happened is that we've seen actors like Ecopetrol, for instance, or even EASA shifting their focus into more renewable energy projects rather than oil and gas projects and transmission projects. So we see a very intense dedication of some of these companies to try to show results in carbon capture, hydrogen production and renewable projects. But there's a paradox here. On the one hand you have the government pushing a lot for the development of, for instance, clean energy projects like solar and wind, but you go down and see how the governmental agencies are approving or granting the permits for those projects – it is a nightmare and they take, in some cases, two to three years.

What we saw like three or four years ago was an influx of lot of, for instance, Spanish developers of wind farms or solar farms trying to sell them over to the EDFs or RNLs of this world and they weren't able to develop a lot of them because of the governmental agencies not rapidly granting the licences or permits. So we're now facing a backlog of projects, especially in the renewable sector, which are trying to come out to the market and some of them are even about to become insolvent or default on their obligations under the options that the government had launched for them to enter into the grid. So it is a contradiction in itself that the country offers itself out to international market as a potential La Vida, and we market all of those environmentally friendly policies, but our governmental agencies just simply won't run the licences.

On the other hand, we are also seeing – although in very shallow capital markets that we have – that our superintendency of finance is also moving to the GRI, Global Reporting initiative, and all of those types of reporting and its sustainability accounting boards, the local issuers are going to have to start complying with that. We also see a number of local companies trying to finance themselves with green bonds. I would say it is a prevalent trend that is going to affect a majority of especially the public utilities and commodity-intensive industries. What we're seeing now is the oil and gas companies of the country, even the transport companies are developing a sustainable area. So they all have their flavour of the month, trying to develop those areas.

From a social perspective we see a lot of government interest in the new national development plan. They rolled out an initiative, instead of the 'private public associations', it's called 'popular public associations'. These give a special advantage to ethnic groups – African American communities, LGBTQ+ actors – so the private sector is going to have to compete against these communities that our government believes were segregated or mistreated for the past 450 years as a result of the ancestors. But it's something that's very unique; these guys are going to have privileges and preferences in contracting with the government. They will overrule a better economic offer from a private party if they are organised as African Americans or indigenous peoples so we're going to start seeing a lot of social impact in that sense and maybe that will give way to being approached by clients saying: "okay, how can we subcontract these popular African-American and indigenous peoples so that we can indirectly present ourselves to the auctions and the public bids with an advantage or a competitive advantage?" So people just accommodate, they manage to become ingenious in the sense of accommodating to a market and we're going to see a lot of social concentration of our government trying to develop a much more prevalent conscience around these ethnic groups or parts of the population.

Lozano: That is very interesting. Again, like with every topic and with this particular group, there's so much more to say. Suffice it to say for now that, from a more philosophical perspective, stockholder capitalism is important for all of us. The tension that we were all hearing in Jaime's voice between the importance and the relevance of these topics, the sustainability of business, not only from an environmental perspective but from a social and economic perspective, and the actual ability of businesses to continue to do what they do and be profitable is not an easy one to solve.

I think philosophically we all want more sustainable ways to do business. We, especially in Latin America, have seen the results of neglecting the disparity among citizens and if we don't take care of that, we will face issues that are far greater than some of the challenges that this presents. We saw it in Chile, we saw it in Colombia – it could escalate. So there is a very significant tension between what we know we have to do to make capitalism sustainable and how we do it and how we get there. We cannot break businesses, because without private enterprise there is no growth and there is nothing to redistribute. I think we tend to agree on this here and that is the challenge. We didn't get to talk about the pink wave or populism, but we're going to have to find – as advisors, together with our clients and bankers, with our ability to influence government where we can in the right ways, in thinktanks and in other manners that impact ESG – a way to support this transition without breaking business. We actually should materialise the intention of promoting sustainable and inclusive businesses in all sorts of ways – inclusive in economic, racial, social, gender and all aspects.

So with that, there's so much more to say about ESG but I know we all have to go. I thank you all so much for participating in this roundtable and for answering my questions and providing an accurate perspective of each of your M&A markets as of now and into the future. It's been, as always, very informative. Finally, can each panellist tell us if they're optimistic for the future of M&A in what remains of 2023 and 2024?

Tornovsky: I do not have a crystal ball, but I am very optimistic as always. I think that the recovery of the economy after the impact of the covid-19 pandemic may lead to increased M&A activity as the market regains the confidence of investors and the economy improves. I think the strategic and financial investors may be more willing to engage in M&A deals to drive growth and expand their market presence. That's my take.

Lozano: Right. Manuel, let's hear from you.

Galicia: The world is changing and it's changing very, very fast. I think there is no more 'business as usual'. This is good news for M&A practitioners because there are many ways we can now help our clients – not only in helping them close a deal. Now we are also instrumental in helping clients identifying, managing and somehow implementing mitigations for those risks. There is a lot we can do in advising our clients to make their business more sustainable. I see this as a very optimistic scenario. As you mentioned, Paola, this is not limited to M&A. It's also getting complicated to get financing structure because today the risk of closing but implementing a transaction has become essential and I think there is a big role we can play. Thank you again for your invitation and being able to participate in this conversation.

Lozano: Fantastic, Manuel. Lao let's hear from you. There're going to be a lot of changes coming up with your election process.

Olmos: Hopefully we can enter into a more rational stage in Argentina and we can capitalise a lot of opportunities that we already mentioned. I am quite optimistic when it comes to M&A lawyers do add value to the table. As Manuel indicated, there is no plug and play. We are more in a tailored business, so I am very optimistic about that. Of course, global challenges will have an impact on our job, but I like that, I like challenges. S o I thank you again, Paola and Daniel, for having me, and thank you Latin lawyer. It's been a pleasure to share this panel with all these esteemed colleagues.

Lozano: Thank you, Lao. Jaime, what do you think? Should we have reason to be optimistic about M&A activity in Colombia?

Robledo: Yeah, I think we do. Well, I'm a natural optimist so you wouldn't hear anything different from me, but I think there are a number of reasons why we should be optimistic. The first one is a global reason I think interest rates in the United States will come down. That will give a lot of air for M&A activity worldwide and I think that the cycle of M&A is starting to recover.

Locally, I think that after October when we see local elections here, we will see a shift to the right. We're already seeing that in the polls. The mayor of Bogotá, the mayor of Medellín, the mayor of Barranquilla and the mayor of Bucaramanga, which are the more principal cities, will most likely be centre or right-wing candidates. The same will occur with governors. I think that the market will factor that into their uncertainty and will start seeing that this government is going to be two more years of a lot of populist BS, but not a lot of reality. I think that will also translate into our government, which cannot continue to turn a blind eye to the oil and gas potential of this country. So I think that will also generate new opportunities. I do think that the near-shoring opportunity will open up in a much better way. Political factors will clear up a little bit and I am optimistic that we will see more M&A activity in Colombia, which has a lot of potential.

Lozano: Fantastic, and I agree. Last but definitely not least, Iván, from a European, Spanish and more global perspective: what is your take?

Delgado: Thank you, Paola. I will start by saying that I'm very optimistic. The money is there. The investors want to continue investing. Latin America has great assets and great people. The region is full of opportunities and for European investors it is difficult, believe me, to grow elsewhere. So I'm more than optimistic. I'm positive that the region will grow with European investments. And thank you so much.

Lozano: Thank you so much, everyone. Gracias.

Part II

Key Players in Latin American M&A

CHAPTER 2

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

Federico Grebe, Rafael Boisset, Claudia Barrero and Martín Cruzat[1]

Introduction

What do we think of when we hear the term 'multilatinas'? This novel term was first coined by Álvaro Cuervo-Cazurra in 2010 to refer to companies in countries formerly colonised by Spain, Portugal or France that have added-value operations outside their country of origin.[2] They not only export products but have regional operations that represent a significant part of their balance sheet. Studies have shown that multilatinas are generally family-owned groups[3] or companies with a privately held controlling shareholder or group of shareholders (e.g., Telmex, Camargo Corrêa Cimientos, Aje Group, Cencosud, Falabella, Grupo Gloria), which have a presence in countries other than that of their origin.[4]

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1 Federico Grebe, Rafael Boisset and Claudia Barrero are partners, and Martín Cruzat is a senior associate, at Philippi, Prietocarrizosa, Ferrero DU & Uría. The information in this chapter was accurate as at October 2022.

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

3 See the 'M&A Involving Family-Owned Targets in Latin America' chapter in this guide.

4 América Economía, a Latin American business magazine goes even further: in its ranking of multilatinas for 2019 it includes only companies that had sales in 2018 of more than US$230 million and relevant operations in at least two other countries in the region. Based on these criteria, companies that have successfully managed to expand their operations to other countries, such as Leonisa, a Colombian lingerie retailer, Fogo de Chão, a Brazilian steakhouse, Astrid y Gaston, a Peruvian Michelin-rated restaurant,

Multilatinas were forged during the economic and political ups and downs of the region. For one part, the legal particularities of Latin America favoured the development of highly concentrated family-owned businesses, as civil law institutions (highly influenced by the Napoleonic system of French civil law) offered less protection for minority shareholders and creditors (which, in turn, inhibited the development of capital markets and debt tapping by Latin American companies).[5] On the other hand, the import substitution policy between the 1940s and 1980s – characterised by high levels of governmental regulation and intervention, as well as debt crisis, high inflation rates, closed markets and political instability[6] – protected local companies from foreign competition and thwarted international development strategies, which forced companies to expand on their domestic markets.[7]

Upon the introduction of free market measures in the late 1980s to early 1990s, local companies were forced to restructure, redefine strategies and improve their competitive capacities through the acquisition of technology and through alliances with foreign companies.[8] Many of them, upon waves of privatisation, acquired assets at discounted prices and set up dominant positions.[9]

Chilean companies were the first to expand and become multilatinas, due to Chile's open economy, mainly through investments in Argentina, capitalising on the benefits of high copper prices and available financing at low interest rates.

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to name only a few, cannot be considered multilatinas, as they have increased their exports within the region but not their presence, whereas companies or groups such as Grupo Bimbo, Cencosud, Falabella, Grupo Gloria, Bancolombia and Gerdau, to name a few, have built added-value operations in several countries throughout the continent. Available at https://www.americaeconomia.com/negocios-industrias/multilatinas/ranking-multilatinas-2019-creciendo-con-valor (accessed 5 August 2021).

5 Casanova, L, et al., 'From Multilatinas To Global Latinas: The New Latin American Multinationals' (Compilation Case Studies) (IDB, 2008). Available at https://publications.iadb.org/publications/english/document/Multilatinas-to-Global-Latinas-The-New-Latin-American-Multinationals.pdf (accessed 4 August 2021).

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

7 Casanova, L, et al., op. cit. Cuervo-Cazurra, A, 2010. 'Multilatinas'. Universia Business Review, (25), pp. 14–33. Available at https://www.redalyc.org/pdf/433/43312280002.pdf (accessed 1 September 2020).

8 ibid.

9 Kandell, op. cit.

During the *corralito*,[10] Argentina's currency was devaluated and investors fled the country. Chilean companies, willing to assume the risk, swept in and invested heavily, mainly in retail and agribusiness. During this time, Cencosud became one of the first multilatinas,[11] and in the past two decades more companies have become multilatinas owing, among other things, to economic reforms that affected their country of origin, the saturation of local markets compounded with the lower amount of domestic opportunities, and the need to diversify the risk portfolio and access new sources of capital.[12]

Role of multilatinas in M&A in the region

Outbound M&A by multilatinas

Historical and market circumstances (as detailed above) gave multilatinas the opportunity to expand throughout the region. Although there is no unique pattern to the internationalisation of multilatinas, certain common characteristics include their flexibility and ability to make quick decisions, their strong and dynamic leadership, which can successfully guide the organisation through new challenges, and their offering of products or services to low-income markets.[13]

Outbound transactions by multilatinas not only increase their regional presence but also their share price. According to a study published by the Boston Consulting Group, the share price of multilatinas that are serial acquirers appreciated by

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

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

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

13 The Economist Intelligence Unit, 2007. 'Business Intelligence On 205 Economies'. Viewswire. Available at http://viewswire.eiu.com/index.asp?layout=VWPrintVW3&article_id=882270073&printer=printer (accessed 1 September 2020). For example, Grupo Nutresa, a food processing conglomerate whose main shareholders are Grupo Sura and Grupo Argos, has grown in the past decade, through, among other things, a series of acquisitions, including Cameron's Coffee in 2019, Productos Pasarela in 2018 and fast-food chain El Corral in 2015, with international sales in 2019 accounting for US$1.142 million of its sales, in comparison to those of 2016, which represented only US$262 million.

almost 70 per cent from 2010 to 2018, as a result of their cross-border M&A activity. In this sense, the valuation of multilatinas has been aided significantly by acquisitions throughout the region.

In the past decade, the volume of outbound M&A by multilatinas has been positively affected by divestitures in the region by their European counterparts,[14] particularly in the banking industry, as evidenced by the volume of transactions undertaken by Colombian and Chilean companies, including the following:

- Grupo Sura (Colombia) acquired ING's pension and investment funds assets in Chile, Mexico, Peru, Uruguay and Colombia;
- Grupo Gilinsky (Colombia) acquired HSBC's operations in Colombia, Uruguay and Paraguay;
- Corpbanca (Chile) acquired Grupo Santander's and Helm Bank's operations in Colombia; and
- Grupo Aval (Colombia) acquired Banco Centroamericano BAC Credomatic, owned by General Electric; purchased Horizonte from BBVA, Davivienda (Colombia); and expanded in Central America, by purchasing HSBC's assets in Costa Rica, Honduras and El Salvador.

Until a few years ago, transactions such as those listed above were almost only within the realm of North American or European companies. However, the growth of multilatinas, their capacity to adapt and their ability to transform their resources have allowed them to successfully compete regionally.[15] For example, Grupo Nutresa adapted its products to each country in the region to meet the needs and preferences of the local customers;[16] Cemex started to expand in the 1990s throughout the region to hedge against market uncertainties in Mexico, which allowed it to consolidate its cash flows and be less dependent on the Mexican market;[17] and the merger of TAM and Lan Chile in 2012 – which formed Latam Airlines – allowed it to enter new markets and increase the destinations offered. As the number of M&A transactions in the region increases, so do transactions

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

15 ibid.

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

17 Casanova, L, et al., op. cit.

related to transactional services companies. For example, Credicorp Capital, BTG Pactual and Larrain Vial have expanded their presence and services throughout Latin America owing largely to the investment and trading appetite in the region.

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

Divestitures by multilatinas

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

Some multilatinas may look at divestitures to sharpen their strategic focus on their core business to create more value to shareholders, increase synergies and reduce costs,[18] while others may seek to divest assets in order to clean their balance sheet, present better ratios, improve financial positions and obtain liquidity.[19]

When considering a divestiture, an issue to be addressed early on by a multilatina that consolidates financial statements throughout several jurisdictions is whether the transaction's value can be enhanced by preparing carve-out financial statements for the business or assets being sold. This is not only a strategic decision,

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

19 For example, in 2017, JBS, a Brazilian meatpacker and one of the world's largest meat processing companies, announced a sale of assets to raise around US$6 billion to cut debt and reduce leverage, in the middle of a corruption scandal that plagued its controlling shareholder. More recently, Empresas Públicas de Medellín, a Colombian public utilities company, commenced the sale of its minority interest in ISA and other assets throughout Latin America to finance the construction of Hidroituango, a hydroelectric plant in Colombia. Petrobras, the Brazilian stated-owned oil company, plans to reduce its hefty debt load in the next four years by selling US$20 billion to US$30 billion in assets. Another reason a company such as a multilatina may consider a total or partial divestment is to improve its cash flow or obtain cash in the short term, through the sale of high-performing assets or non-strategic minority stakes.

but a time-consuming one: the assets, liabilities and operations to be included in such financial statements must be clearly identified, and the document is then generally certified by an independent accounting firm. As the carved-out business or assets are part of a much larger operation, challenges usually arise in preparing the pro forma financials when the carved-out business or assets are not organised separately within the company or when there are assets, liabilities and operations that are shared with other business units within the same group. Other issues to consider in divestitures are the termination of intercompany agreements and the execution of transitional services agreements to ensure business continuity.

Multilatinas usually have an interconnected business with people, processes and systems deeply integrated within their business or services and infrastructure shared across multiple business units. Before executing a transaction, a time-consuming process for any multilatina will be identifying and carving out the pieces, business processes and applications that have to be sold with or separated from the divested asset. For this reason, the need for, and terms of, the termination of any intercompany agreement, and the rendering of any necessary transitional services agreement must be determined in the early stages of the transaction. A transitional services agreement may cause the parties to require a longer than expected pre-closing or integration period and can jeopardise seamless transitions for the business, its customers and employees. It is advisable to carefully consider costs, standards of service and competitive concerns, as well as data-sharing restrictions.

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

Impact of multilatinas entering private auctions on the buy-side

Multilatinas have dynamised private M&A auction processes in many ways. Importantly, their acute knowledge of the risks of the region and a willingness to assume them gives them an edge in certain competitive processes. New entrants to the region, on the other hand, have to familiarise themselves (and become comfortable) with local authorities, regulatory approvals, currency fluctuation, market and industry risks. In this sense, for a seller in a private auction, the pre-signing transaction timeline can be shorter and the transaction agreements can reflect reduced pre-closing risk if the buyer is a multilatina as compared to global or foreign bidders. To the extent the multilatina is already in that market, due diligence timelines can also be reduced.

Another aspect that can differentiate multilatinas from other bidders in a private auction is their corporate governance. In our experience, multilatinas tend to have a more highly developed corporate governance structure than smaller local family-owned companies, because, among other reasons, they often have already tapped the capital markets, which helps them to operate in several countries simultaneously as well as to secure financing to execute acquisitions. This improved corporate governance structure does not prevent multilatinas from being agile and flexible when taking strategic decisions. The strong and dynamic leadership of multilatinas is also a success factor when competing for a target in an auction. In fact, the corporate governance structures implemented by multilatinas can also assist them in their growth.[20]

20 In a 2017 interview with the Organisation for Economic Co-operation and Development (OECD), the CEO of Grupo Energía de Bogotá when discussing the company's strategic corporate plan and its medium and long-term goals stated that 'this cost-effective growth strategy will be executed though investments in leading regional companies, global strategic partners, the best human talent available and corporate governance standards that abide by OECD guidelines.' OECD, 2017. 'Business Brief: Unleashing Latin America's Energy Potential'. Available at https://www.oecd.org/colombia/business-brief-unleashing-latin-americas-energy-potential.htm (accessed 1 September 2020).

Regulatory and political challenges for multilatinas

Regulatory matters involving publicly traded multilatinas

Capital is essential in order to become a multilatina. To this end, a number of multilatinas have looked towards capital markets for liquidity. This is evidenced by the fact that of the 30 largest multilatinas in 2021, as ranked by America Economía, less than five are privately held in their entirety. Once listed, companies can raise additional capital through the issuance of equity and are more likely to be able to execute stock-for-stock transactions, allowing them to expand without significantly affecting their balance sheet. For example, between 2015 and 2017, Grupo Argos executed a two-part acquisition of Odinsa, a company dedicated to the structuring, promotion, management and development of infrastructure projects in Colombia, which was partly paid in stock. By using its own equity, Grupo Argos minimised cash disbursements and limited the impact of the transaction on the company's balance sheet. Listed companies have also become subject to greater scrutiny and more regulation, and therefore must adopt a sophisticated corporate governance structure. Such a corporate governance structure usually engenders the trust of investors, the public and financial institutions, increasing their profile and, more importantly, providing them with more access to local and international financing sources.

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

Merger control challenges

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

Most Latin American jurisdictions have adopted some type of merger control regime, with the Dominican Republic, Guatemala, Guyana and Bolivia being the notable exceptions. As multilatinas expand throughout the region, the different laws and levels of experience of the regulations in each jurisdiction and the lack of mandatory cooperation between regulators have added a degree of complexity to transactions in which multilatinas participate. This includes changes in the application of antitrust laws and the existence of new statutes.

Peru recently enacted a new merger control regulation (Law No. 31112), which came into force on 14 June 2021. As with any new regulation, there is uncertainty regarding its application by the Peruvian Antitrust Authority (INDECOPI). Among its most important characteristics are:

- all economic concentrations (i.e., change or transfer of control) require authorisation if they meet the following thresholds:
  - the total value of either the assets or the annual sales (or gross revenue) of the companies in Peru in the previous financial year equals or exceeds 118,000 tax units (UIT); and
  - the total value of the assets or the annual sales (or gross revenue) in Peru of at least two of the companies involved in the transaction in the previous financial year equals or exceeds 18,000 UIT;
- INDECOPI may review ex officio, up to one year after closing, any transaction that does not meet the thresholds if it creates a dominant position or affects competition;
- the procedure for obtaining clearance can take up to 30 business days in Phase I and up to 120 business days in Phase II; and
- INDECOPI will enforce gun-jumping rules from day one.

In addition, Chile has a very well established and respected merger control regime, with its antitrust agency (the National Economic Prosecutor (FNE)) conducting reviews of different types of merger transactions. A recent development is that the FNE is using a very powerful tool that provides them with the ability to open investigations into certain mergers that fall below the thresholds and therefore were not previously reviewed. Specifically, Chilean regulation establishes that the FNE is entitled to review such a deal within one year of the deal closing, which the FNE has done in connection with certain mergers that it has considered might have potential effects on the market. In addition, the merger control regulation has been adapting to be more transaction-friendly, incorporating fast-track approval mechanisms for transactions with no overlap between the parties' activities; strengthening and providing greater certainty at the pre-notification stage; diminishing the documentation requirements to fulfil the agency's checklist; and advancing risk analysis to earlier stages to enable the parties to offer adequate remedies for the agency antitrust concerns.

While in Colombia there have not been any recent major changes to the current merger control regulation, filing fees for merger control review processes were recently implemented. The fee depends on the specific type of merger control procedure applicable to the proposed transaction, and potentially on the combined revenues of the parties to the transaction (for Phase II cases). In terms of enforcement practices, the Colombian competition authority has modified its position regarding the participation of interested third parties in merger control proceedings. While previously a third party that was able to demonstrate a direct interest in the result of the review process could be allowed to act in the proceedings with the ability to submit arguments, request evidence and file appeals, this is no longer a possibility under the current position of the competition authority. Based on recent decisions, the Superintendency of Industry and Commerce changed its initial interpretation, concluding that interested third parties are not allowed in merger control proceedings, since they are not provided for in the law.

From a contract standpoint, while parties typically default to a 'hell or high water' clause on antitrust matters, an obligation to divest up to a limit or a reasonable efforts clause without specific obligation to remedies, multilatinas are acquainted and familiar with the authorities and the regulatory issues of the region. Therefore, they may be amenable to an equitable distribution of risk between the parties, or may accept a more seller-friendly provision, provided that its obligations are not excessively burdensome and do not have an economic impact that materially affects the value of the transaction, the business or its current operation.

Regarding public policy, there have been regional integration efforts to unify the process for cross-border mergers and acquisitions.[21] On 29 April 2020, the members of the Andean Community approved a regulatory framework to formulate and harmonise regulatory policies for merger control. This framework seeks to promote in its member states the formulation and implementation of

21 The members of Mercosur advocated for common rules for merger control through the Fortaleza Protocol but the initiative was brief as the protocol was only ratified by two member states and therefore not implemented. Similarly, in the Declaration of Lima, Chile, Colombia and Peru created an informal forum to foster cooperation between each country's competition authorities but the declaration contained no regulation regarding cross-border transactions or other firm obligations.

public policies related to antitrust matters. On a more regional level, differences in the merger control undertaken by each country, the level of development of their laws, restrictions relating to the sharing of information and the lack of mandatory information sharing practices are some of the barriers the region must overcome to implement regional merger control practices. However, this in no way is a material obstacle to the growth and expansion of multilatinas, and in some cases can even prove to be an advantage for them.

The pandemic and M&A throughout the region

Although Latin America has had a degree of political and economic stability (at least regarding the Pacific Alliance countries) for the past two decades, the governments' reaction to the covid-19 pandemic through prolonged – and in some cases, draconian – lockdowns have generated severe economic consequences, and have led to severe political crisis and prolonged social protests throughout the region. In some cases, this is manifesting in potential changes to the very structures that allowed multilatinas to thrive and expand.

As such, some multilatinas have chosen to restructure their activities and exit certain markets. Falabella, for example, chose to progressively wind up its activities in Argentina due to (1) the hard devaluation of the currency and the impact on its balance sheet; (2) the lack of interest of any retailer in acquiring the activities in Argentina or being a strategic partner; and (3) the impact of prolonged lockdown on physical retail stores.[22] Its last physical retail stores were closed in April 2021. While the group planned to keep an online retail presence, it finally closed down its online retail operation in May 2021.[23]

Grupo Salinas (the Group), however, wound up its operations in Peru as the result of a series of different factors. On the one hand, it sold off its banking arm – operating under the Banco Azteca brand – to a small group of Peruvian investors.[24] The Group mentioned it would be focusing its efforts on Mexico,

22 'Falabella acelera su salida de Argentina y cierra sus últimas 3 tiendas'. Available at https://rpp.pe/economia/economia/falabella-acelera-su-salida-de-argentina-y-cierra-sus-ultimas-tres-tiendas-empresas-noticia-1331355 (accessed 28 September 2021).

23 'Falabella se despide definitivamente de Argentina con cierre de su tienda online'. Available at https://www.eleconomista.com.mx/empresas/Falabella-se-despide-definitivamente-de-Argentina-con-cierre-de-su-tienda-online-20210602-0174.html (accessed 28 September 2021).

24 'Banco Azteca sale de Perú para enfocarse en otros mercados'. Available at https://lexlatin.com/noticias/banco-azteca-sale-peru-mercados (accessed 28 September 2021).

the United States and Central America.[25] On the other, the Group closed all of its stores under the 'Elektra' brand in Peru due to the effect of the prolonged lockdown in Peru (one of the longest and strictest in the region), as well as a diminished financial position after the sale of Banco Azteca's operation.[26]

The pandemic also generated opportunities for certain investors. Brazilian private equity firm IG4 acquired Peruvian multilatina Aenza (previously Graña & Montero) in 2021, through a tender offer for the company's shares and ADR, as well as a syndication agreement,[27] and after a prolonged negotiation that included the company reaching certain agreements with the Peruvian state regarding the company's involvement in the Lava Jato scandal. The fund also announced its intention to spin off the construction, real estate and oil and gas operations of the company and focus solely on infrastructure.[28]

In August 2021, Camil Alimentos took the opportunity to acquire Alicorp's asset in Brazil, Pastificio Santa Amalia SA, to expand its geographical footprint in Brazil and expand into new categories of products while Alicorp refocuses its efforts in other markets.[29]

Future trends and final thoughts

While the covid-19 pandemic caused an impact economically in Latin America, and political instability resulted in defensive measures from certain economic groups, the market is ripe with opportunities for multilatinas. On the one hand, economic groups in countries going through political upheaval are conservatively creating significant cash reserves abroad and have a certain amount of liquidity to invest in jurisdictions other than their original ones, whether looking for stability or diversification. On the other, businesses affected by the pandemic

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25 'Grupo Elektra anuncia la venta de Banco Azteca del Perú'. Available at https://www.grupoelektra.com.mx/News/PDF.aspx?idPdf=1928&lang=es&tp_doc=6&sit=IRTVA (accessed 28 September 2021).

26 'Elektra: estos hechos que anticiparon su salida de Perú'. Available at https://www.forbes.com.mx/elektra-hechos-anticiparon-salida-peru/ (accessed 28 September 2021).

27 'Brazil's IG4 acquires stake in Peruvian infrastructure group Aenza'. Available at https://latinlawyer.com/cross-border-ma/brazils-ig4-acquires-stake-in-peruvian-infrastructure-group-aenza (accessed 28 September 2021).

28 'Grupo peruano Aenza, controlado pelo IG4, vai focar em infraestrutura e fará spin off'. Available at https://6minutos.uol.com.br/negocios/grupo-peruano-aenza-controlado-pelo-ig4-vai-focar-em-infraestrutura-e-fara-spin-off/ (accessed 28 September 2021).

29 'Alicorp deja Brasil: Camil adquiere subsidiaria Santa Amália por US$ 77 millones'. Available at https://larepublica.pe/economia/2021/08/17/alicorp-deja-brasil-camil-adquiere-subsidiaria-santa-amalia-por-us-77-millones/ (accessed 28 September 2021).

will be looking to divest certain assets, where multilatinas that have a solid cash position and cultural affinity will be able to acquire opportunistic M&A, most likely at a discount.

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

An interesting trend related to the rise of multilatinas is the increasing appeal of venture capital, where established firms are collaborating with innovative start-ups in what is called corporate venture capital. According to Global Corporate Venturing Analytics, in 2018 there were 1,620 active corporate venture operations, in comparison to the 375 that existed in 2011. The volume of venture capital operations in Latin America is much lower than that in Asia and the United States, but in the first three quarters of 2019 the venture capital activity in the region grew 151.2 per cent from US$700 million to US$1.6 billion, and has been steadily growing ever since, reaching a record-breaking year in 2021 with US$14.8 billion. Multilatinas such as Grupo Sura, Grupo Crédito, Petrobras, Grupo Bimbo and Falabella have already embarked on corporate venture capital through corporate incubators and accelerators, scouters, venture builders and start-up acquisitions, and are likely to continue investing in all sorts of industries, particularly fintechs and companies that have undergone multiple financing rounds, such as Colombia's Rappi, Mexico's Clip and Brazil's Creditas. These corporate activities, together with government programmes such as Ruta N, StartUp Peru, 500 Startups, Startup Farm and Corfo and other external factors have increased venture activity in the region, as evidenced by the number of unicorns that emerged in Latin America in the past decade.[30] As the market matures and funding increases, venture capital deals will increase and start-ups

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

will consolidate and become the future multilatinas. Japanese conglomerate Softbank announced the creation of a US$5 billion investment fund for Latin America and has already invested US$1 billion in Rappi, a Colombian unicorn.[31]

On a final note, Latin America and its people are known for their creativity, grit and resilience, and in many ways for growing in spite of their governments. While covid-19 has certainly generated challenges for the region, let us not forget that multilatinas have been forged through the ups and downs of the region, and certainly know how to navigate difficult environments, diversify and make the best of the opportunities presented. In addition, new generations of entrepreneurs are contributing to the growth of a variety of enterprises and industries in the region, even in current market conditions. For example, Peruvian start-up Crehana recently raised the largest Series B round of financing for an edtech in Latin America.[32] Latin American democracies have been forged through crisis and the current unrest in the region will result in more robust institutions and the growth of its people.

31 See the 'Key Terms and Trends in Venture Capital Investments' chapter in this guide, for insight into venture capital dealmaking in the region.

32 'Crehana Raises Largest Series B for Edtech in Latin America'. Available at https://www.generalatlantic.com/media-article/crehana-raises-largest-series-b-for-edtech-in-latin-america/ (accessed 10 August 2021).

CHAPTER 3

Private Equity Funds and Institutional Investors in M&A

Maurizio Levi-Minzi, Peter A Furci, Andrew M Levine and Sergio Torres[1]

The pace of private equity activity in Latin America appears to have stalled in the first half of 2023, buffeted by geopolitical concerns, spiking inflation and high interest rates.[2] Nevertheless, the long-term trend towards greater penetration of the regional M&A markets by private equity strategies remains clear.[3] Private equity funds and institutional investors play an increasingly prominent role in Latin American M&A activity, and trends such as 'nearshoring' may increase further the region's attractiveness for investors.[4] This shift also reflects the increasing acceptance in Latin America that private equity can accelerate the growth of businesses with expansion potential and, in the case of technology and infrastructure, provide essential long-term capital. More broadly, private equity funds and institutional investors offer:

- much-needed capital to finance promising enterprises;
- business practices and models that enable local companies to leverage strategies already road tested in other markets; and

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2 According to Preqin Pro, the reported aggregate deal value of private equity activity in Latin America in Q3 2023 was approximately US$300 million, compared with US$2.1 billion in Q3 2022.

3 According to Preqin Pro, the reported aggregate deal value of private equity activity in Latin America increased from US$9 billion in 2021 to US$16.6 billion in 2022.

4 'In An uncertain world, Latam M&A is on the rise', KPMG, https://kpmg.com/xx/en/home/insights/2023/06/kpmg-2023-m-and-a-in-latam-survey.html.

- advanced corporate governance practices that strengthen the transparency and durability of local enterprises.

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

- the sectors that private equity funds and institutional investors target;
- the emphasis on flexible contractual protections that allow private equity and institutional investors to 'roll with the punches'; and
- the valuation and exit approaches used by private equity and institutional investors in Latin America.

For instance, during 2022, M&A activity in Brazil experienced a slight slowdown amid global economic uncertainties, but deals in the energy, natural resources, manufacturing and services sectors rebounded strongly, accounting for 66 per cent of deal value in that year.[5] Two examples of strategic deals that underscored this theme were ArcelorMittal's acquisition of Companhia Siderúrgica do Pecém for approximately US$2.2 billion[6] and the sale of Enel Brasil SA's entire stake in Brazilian power distribution company CELG Distribuição to Equatorial for approximately US$1.6 billion.[7]

5 In 2022, energy and natural resources, and manufacturing and services accounted for 66 per cent of the value of Brazil's dealmaking; see Luis Frota, Felipe Cammarata and Leonel Lima, 'M&A in Brazil: A Nation Prepares for Changes', Bain & Company (31 January 2023), www.bain.com/insights/brazil-m-and-a-report-2023.

6 'ArcelorMittal completes acquisition of CSP in Brazil', Bloomberg, 9 March 2023, www.bloomberg.com/press-releases/2023-03-09/arcelormittal-completes-acquisition-of-csp-in-brazil.

7 'Enel group finalized sale of Brazilian electricity distributor in Goiás', Enel, 29 December 2022, https://corporate.enel.it/en/media/press/d/2022/12/enel-group-finalized-sale-of-brazilian-electricity-distributor-in-gois-.

Additionally, Brazil's largest hospital network Rede D'or's acquisition of SulAmerica for approximately US$2.6 billion and BTG Pactual's US$2.4 billion investment to acquire a controlling stake in V.Tal exemplify investors' opportunistic approaches in the current environment. While the region still seems to be dominated by strategic players, Ontario Teachers' Pension Plan and Alberta Investment Management Corporation's acquisition, through its controlled subsidiary Grupo Saesa, of a 99.09 per cent interest in Enel Transmisión Chile for US$1.5 billion highlights the growing footprint of institutional investors in the region.[8]

Another notable development is the increase in M&A activity in Mexico.[9] In the covid-19 pandemic's aftermath, global manufacturers are considering relocating their supply chains to take advantage of nearshoring, and Mexico appears to have emerged as their destination of choice. As a result, Mexico is experiencing an export boom, with record foreign investment activity.[10] Other sectors, such as fintech, have also made inroads into Mexico, with Warren Buffett-backed Brazilian unicorn Nubank investing US$1.3 billion in its operations in Mexico.[11] The repositioning of global supply chains towards Mexico and, more generally, Latin America is expected to draw more M&A to the region.

Overcoming intrinsic challenges

The most noteworthy economic challenge that foreign private equity and institutional investors confront in Latin America is the dramatic volatility of many local currencies. For example, over the past two decades, since the adoption of the floating exchange rate regime, the currencies of the two most important economies in the region (Brazil and Mexico) have fluctuated in a manner that

8 'Enel Chile Completes the Sale of its Electricity Transmission Business', Enel, 9 December 2022, www.enel.cl/en/meet-enel/media/press-enel-chile/d202212-enel-chile-completes-the-sale-of-its-electricity-transmission-business.html.

9 According to Refinitiv, the volume of announced M&A deals in Mexico surged 55 per cent in H1 2023.

10 Leda Alvim and Maya Averbuch, 'US Nearshoring Wave Grows as Mexico Exports Jump Close to Record', Bloomberg, 28 June 2023, www.bloomberg.com/news/newsletters/2023-06-28/supply-chain-latest-us-nearshoring-proof-grows-as-mexico-exports-jump.

11 Carolina Millan, 'Buffett-Backed Nubank Bets on Mexico for "Pivotal" Growth', Bloomberg, 4 August 2023, www.bloomberg.com/news/articles/2023-08-04/buffet-backed-nubank-bets-big-on-mexico-for-pivotal-growth.

has impacted the investment process in various ways.[12] Exchange rate volatility makes valuations at entry more difficult given uncertainties in valuing future cash flows. It also creates the need to allocate exchange rate volatility risk between signing and closing, which could take up to several months depending on the closing clearances or corporate reorganisations required. Exchange rate volatility also can hinder an exit where a seller needs to monetise an investment during a period of local currency devaluation. Since hedging extremely volatile currencies is not economically viable, investments in Latin America by foreign private equity funds and institutional investors must be made in spite of foreign exchange risks. However, this risk is not necessarily a concern for domestic private equity funds and institutional investors funded primarily in local currencies and that likewise report their results in local currencies. As domestic private equity funds and institutional investors grow, we would expect that they will be able to leverage their 'currency advantage' in auctions.

The second most significant economic obstacle to private equity investments in Latin America – which domestic players share with their foreign counterparts – is the limited availability and cost of leverage as a key private equity strategy. Historically, limited availability of credit to finance buyouts and minority investments, as well as competition from cheaper financing sources, including from state-owned developing banks, discouraged private equity investors in Latin America from using leverage as a key strategy to boost returns. Although legal reforms to build a robust leveraged buyout market are yet to be introduced in the region, there is increasing evidence that investment backed by private credit in Latin America is on the rise; furthermore, the recent higher interest rates have encouraged institutional investors to enter the private credit markets with credit funds.[13]

12 Marcos Chamon et al., *Foreign Exchange Intervention in Inflation Targeters in Latin America* (International Monetary Fund, 2019), www.bookstore.imf.org/books/foreign-exchange-intervention-in-inflation-targeters-in-latin-america.

13 See Bloomberg, 'Private Credit Is Targeting Void Left by Banks in Latin America', www.bloomberg.com/news/articles/2023-02-09/private-credit-is-targeting-void-left-by-banks-in-latin-america#xj4y7vzkg; see also LAVCA, https://lavca.org/industry-data/2023-lavca-year-end-industry-data-and-analysis.

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

- compliance concerns that have appeared to be endemic in some geographies and industries;
- the political volatility of most countries in the region, demonstrated by the following examples:
    - the new constitutional process in Chile, which is expected to conclude by the end of 2023;
    - the 6 January 2023 storming of the Brazilian Supreme Court and other government buildings; and
    - the ambitious left-wing goals of the Colombian government;
- the vulnerability of commodity-driven economies to cyclical external shocks coming from China, the United States or Europe;
- in certain jurisdictions, concerns about 'piercing the corporate veil' and directors' exposure to personal liability;
- transparency issues in the due diligence process, including those related to the target's financial statements;[14]
- markets in which there are few (if any) generally accepted and publicly available contractual terms for M&A deals due to the confidentiality of arbitration awards, resulting in lengthier negotiations and requiring more commitment in terms of the investment team's time; and
- tax complexities, burdensome labour practices and delayed exits due to currency, economic or political factors.

Notwithstanding these challenges, private equity funds and institutional investors have achieved significant successes in Latin America.[15] They have done so by deploying mitigating strategies aimed at: (1) concentrating on robust and resilient sectors of the economy expected to grow over time, such as infrastructure,[16]

14 See the 'M&A Involving Family-Owned Targets in Latin America' chapter in this guide.

15 According to a KPMG report on M&A activity in Latin America, four out of five companies and investors rate their most recent large M&A deal in the region as a success on the whole, 'In an uncertain world, Latam M&A is on the rise' (see footnote 4).

16 Infrastructure assets are a clear favourite for institutional investors in Latin America. In a recent example, the Canada Pension Plan Investment Board acquired a 9.4 per cent stake in BTG Pactual-owned V.Tal, Brazil's largest neutral fibre-to-the home network provider; see Lily Squires, 'CPP Investments acquires stake in V.Tal from BTG Pactual', Latin Lawyer, 14 December 2022, https://latinlawyer.com/article/cpp-investments-acquires-stake-in-vtal-btg-pactual.

technology, consumer products and life sciences; (2) proactively addressing difficulties through pricing and contractual terms; and (3) leveraging their operating expertise to improve both the bottom line and overall performance of the companies in which they invest. These strategic imperatives have been key factors in shaping private equity investments in the region. The many past successes of private equity investments in Latin America demonstrate that savvy and astute dealmakers are aware of these risks and have developed sophisticated strategies to mitigate them.

While the pandemic's impact on the region's economies posed additional novel challenges, its aftermath has brought political risk to the forefront in many countries in the region, including Brazil, Chile, Colombia and Peru.[17] Private equity funds and institutional investors are increasingly focused on the potential impact of the political context on their investment strategies. In this regard, grappling with difficult scenarios has been and probably will continue to be the ordinary course for private equity funds and institutional investors active in Latin America. As discussed below, the business and legal approaches that private equity and institutional investors have developed for the region are designed expressly to navigate through radically uncertain scenarios that are hard to quantify and, therefore, price.[18]

Mitigating risks through contractual rights

A critical element of this mitigation strategy involves negotiating contractual rights that support the sponsors' investment thesis and address the idiosyncratic challenges faced in Latin America. In our experience, particularly in the case of minority-stake acquisitions, the most significant contractual protection relates to the target's business plan and deviations from the plan. Given that management of unexpected developments is a principal concern of private equity and institutional investors in Latin America, it is safe to assume that any plan beats no plan[19] when carrying out a successful acquisition.

17 See Paola Lozano, et al., 'Roundtable: The Impact of Political Instability and Social Unrest on Dealmaking in Latin America', in Paola Lozano and Daniel Hernández (eds), *The Guide to Mergers and Acquisitions* (3rd edition, Latin Lawyer, 2022).

18 Kay, John and King, Mervyn, *Radical Uncertainty: Decision-Making Beyond the Numbers* (W W Norton & Company, 2020).

19 Geithner, Timothy F, *Stress Test: Reflections on Financial Crises* (Crown Publishing Group, 2015).

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

Many businesses in Latin America, particularly family-run businesses, are still accustomed to operating in fairly unstructured and informal manners.[20] For this reason, the introduction of formal planning and, even more importantly, the acceptance by the target's management of processes and procedures calibrated to ensure adhesion to a business plan can sometimes be challenging. In particular, they may require behavioural changes that the controlling shareholder and management resist. This is one of the principal reasons why many of the international private equity and institutional investors that have been most successful in the region have a local team capable of bridging the gap between business cultures. A local team can be critical inasmuch as 'boots on the ground' help overcome deviations from the plan and the nearly inevitable mid-course adjustments.

To protect a proposed investment's economic rationale, other significant factors include:

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

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

20 See the 'M&A Involving Family-Owned Targets in Latin America' chapter in this guide.

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

Private equity and institutional investors in Latin America are also increasingly focused on broader environmental, social and governance (ESG) considerations in negotiating minority protection rights, at least partly under the influence of their limited partners and intensifying public opinion.[21] Investors are more regularly seeking to ensure that investments are environmentally sustainable and have a positive social impact, and that portfolio companies adopt more advanced corporate governance practices. Similar to anti-corruption compliance, regional investors' heightened attention to ESG matters reflects the need to comply with a growing web of related legal and regulatory obligations and also is consistent with the idea that invested companies may benefit from experiences and know-how developed in other markets.

Mitigating strategies through transfer restrictions

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

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

21 See 'The Latin American M&A Market from an ESG Perspective' chapter in this guide.

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

Valuation challenges and competition with strategic players

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

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

It is not unusual for private equity funds and institutional investors in Latin America to find themselves in heated competitive auctions that involve local and international strategic players. As private equity funds and institutional investors are focused on returning capital in the mid-term, strategic players may ascribe higher intrinsic value to assets in light of their longer-term strategic value.[22] This can turn out to be challenging for private equity funds and institutional investors because strategic players may be prepared to pay generously for assets that offer them unique synergies or allow them to defend market positions.

Talent challenges in buyouts

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

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

22 See Gram Slattery and Marta Nogueira, 'Brazil's Vale dam disaster report highlights governance shortcomings', Reuters, 21 February 2020, www.reuters.com/article/us-vale-disaster/brazils-vale-dam-disaster-report-highlights-governance-shortcomings-idUSKBN20F2Q6; see also Juliana Gomes Ramalho Monteiro et al., 'Compliance as a Foundation for ESG Oversight', in Andrew M Levine (ed), *The Guide to Corporate Compliance* (2nd edition, Latin Lawyer, 2021), https://latinlawyer.com/guide/the-guide-corporate-compliance/second-edition/article/16-compliance-foundation-esg-oversight.

Pooling with other investors

To date in Latin America, there have been few instances in which private equity funds have combined with strategic investors to pursue acquisitions together.[23] It has happened where the strategic investor brought special industry expertise relevant to the proposed transaction. These transactions are, however, becoming more common and seem likely to continue to grow in the future.

'Club deals', involving multiple private equity investors, are also relatively rare in Latin America, except for very large privatisations of infrastructure assets.[24] When these transactions involve investors based in and outside the region, participants need to find a consortium equilibrium that reconciles financial objectives and contractual priorities, which often are not perfectly aligned. Since large infrastructure projects are likely to figure prominently in future M&A activity in Latin America, a growing number of club deals will likely occur, including participants that over time will develop a shared approach to these transactions.

On the other hand, co-investments between foreign private equity funds and sovereign wealth funds have been pursued with increased frequency and with some success in recent years.[25] Interestingly, the region is also seeing sovereign wealth funds partnering with domestic private equity funds in acquisitions.[26] Typically, one of the thorniest issues posed by these combinations between

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23 One recent successful case was EIG and Fluxys' acquisition of an 80 per cent stake in GNL Quintero, the largest liquefied natural gas regasification terminal in Chile, from Enagas Chile SpA and affiliates of OMERS Infrastructure, 'EIG and Fluxys to acquire 80% stake in Chile's GNL Quintero', Lavca, 28 March 2022, https://lavca.org/2022/03/28/eig-and-fluxys-to-acquire-80-stake-in-chiles-gnl-quintero%EF%BF%BC. Another example is the US$838 million investment in Newave Energia by Brazilian steel giant Gerdau, NW Capital and funds managed by XP Investimentos; see Davide Montagner, 'Gerdau joins investors to acquire renewables group', Latin Lawyer, 5 January 2023, https://latinlawyer.com/article/gerdau-joins-investors-acquire-renewables-group.

24 One example is the acquisition of a 99.09 per cent interest in Enel Transmisión Chile for US$1.5 billion by Ontario Teachers' Pension Plan and Alberta Investment Management Corporation, through its controlled subsidiary Grupo Saesa (see footnote 8).

25 By way of example, Brookfield Infrastructure acquired a controlling stake in Nova Transportadora do Sudeste SA in consortium with CIC Capital Corporation, 'Brookfield Infrastructure Announces Closing of South American Natural Gas Transmission Utility Transaction', https://bip.brookfield.com/press-releases/bip/brookfield-infrastructure-announces-closing-south-american-natural-gas.

26 One recent example is Brazilian investment fund FIP Agroenergia taking control of ethanol producer Atvos and paving the way for Abu Dhabi investment fund Mubadala Capital to acquire a 31.5 per cent stake in the company; see Peter Frontini, 'Brazil's FIP Agroenergia takes control of ethanol producer Atvos', www.nasdaq.com/articles/brazils-fip-agroenergia-takes-control-of-ethanol-producer-atvos.

private equity and sovereign wealth funds flows from differences in investment horizons and, consequently, misaligned preferences regarding liquidity and exit arrangements. The market has developed some creative solutions to address this misalignment involving separate windows for exit. The important takeaway is that sovereign wealth funds have greater flexibility in investing in Latin America because the limited windows for exit available in these markets typically matter less to these investors.

Tax considerations

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

Tax first arises during the due diligence process, as an investor assesses the target's historical tax compliance and material exposures. In many countries in Latin America, of which Brazil is perhaps the most notable example, ongoing tax disputes between companies and revenue authorities are extremely common. An investor 'learning the ropes' in the region may be surprised, or dismayed, at the extent of a potential target's tax disputes, as compared to other regions. In purchases from creditworthy strategic sellers, historical exposures often can be addressed through a pre-closing tax indemnity. However, many deals involve purchases from a founding family group, or from a financially distressed seller, where obtaining an indemnity can be more challenging and potentially have more limited value.[27] In these cases, it is important to look beyond the nominal exposures to understand context. To what extent do the exposures indicate fundamental compliance issues or unduly aggressive tax planning? Or are they common audit disputes that similarly situated companies are likely to face? Private equity and institutional investors need high-quality advisers who cannot just identify and quantify exposures but can assess commercially whether the risks are reasonable or justify greater contractual or other protections.

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

27 See the 'Indemnity Escrows and Other Payment Guarantees' chapter in this guide.

Of particular note, Brazil has a private equity tax regime (the participation fund (FIP) regime) that enables offshore investors to avoid tax on exit gains so long as certain requirements are met. In recent years, the Brazilian tax authorities have challenged the eligibility of non-resident investors to the FIP exemption, including by arguing that the jurisdiction of the beneficial owners of these investors (and not just that of the investing vehicles themselves) should be considered in assessing whether the domicile requirement is met. In December 2019, the Brazilian tax authorities issued an acknowledgement that the investing vehicles' jurisdiction is the one that should matter, except for a sham or fraudulent circumstances.[28] Although this has been viewed as a positive development, it appears that tax authorities (as well as the local FIP administrators responsible for ensuring payment of withholding taxes by FIPs) have continued to scrutinise indirect beneficial ownership. As a result, many private equity sponsors investing in Brazil have scrambled to restructure offshore fund structures from the Cayman Islands or other blacklisted jurisdictions. These restructurings raise significant legal, tax, administrative and potentially investor relations issues that require meaningful time and attention, and they should be addressed well ahead of portfolio company exits. Although the approval by Brazil's Lower Chamber of a long-awaited tax reform in 2023 sent positive signals to the market, the simplification of the tax regime in that jurisdiction will take years to be implemented.

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

Exits

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

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

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

- perhaps most commonly, a public offer of the portfolio company shares in which the investor sells its shares immediately or over time;
- next most popular, a trade sale or an acquisition by a suitable strategic company interested in acquiring a complementary business;
- a secondary sale to another private equity investor (which may become appealing if the original investor needs to monetise the investment while the business continues to require funding);
- a repurchase of the private equity stake by the original shareholders or management; or
- the least successful approach, a liquidation that happens if the investment fails.[29]

In Latin America, each of these successful exit paths presents some 'bumps in the road'. Public offerings of shares in Latin American companies are challenging because local capital markets are not deep and the window for launching initial public offerings (IPOs) opens only infrequently and often closes fast. When the markets finally open (as, for example, they did in Brazil during 2021), there is a mad scramble to list and a strong sense that it is crucial not to miss this unique opportunity. Of course, the problem is that the 'feast or famine' character of local markets makes it difficult to predict up front, at the time of investment, whether an exit through an IPO is a likely option. The feasibility of a public offering of the shares of a Latin American company in New York or in another international market also is uncertain due to the volatility of the currencies involved. Private equity investors need to consider whether there will be appetite for this additional risk and how this risk will affect the exit price.

Additionally, the role of special purpose acquisition companies (SPACs) in Latin America has been constrained significantly by local legal limitations. However, some regional private equity firms and institutional investors have launched US-listed SPACs with mandates to invest in Latin America and then

29 Alternatively, a distressed M&A transaction may be attempted. See the 'Distressed Mergers and Acquisitions: Lessons from the Venezuela Experience' chapter in this guide.

have rushed to close deals.[30] This development suggests that regional private equity firms and institutional investors are finding ways to bypass Latin American regulators to bring SPACs to the local markets.

Trade sales are a great option for private equity in Latin America if a strategic buyer with deep pockets can be identified.[31] A recent report from the Global Private Capital Association shows that sales to strategic buyers have steadily grown in Latin America and, in 2023, far outnumbered exits through public offerings and sales to financial buyers.[32] Similarly, the market for secondary sales of portfolio companies to other private equity investors appears to be growing in Latin America. The most likely buyers of these private equity stakes, at least in the infrastructure sector, seem to be sovereign wealth funds.[33] Finally, we have not observed many instances of a successful exit was achieved through a repurchase of the portfolio company stake by the original shareholder.

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

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30 Isabela Fleischmann, 'SPACs Rush Into Mergers With Brazilian Companies as Deadline for Listing Looms', Bloomberg Línea, 27 March 2023, www.bloomberglinea.com/english/spacs-rush-into-mergers-with-brazilian-companies-as-deadline-for-listing-looms.

31 Some recent examples include: (1) in May 2023, HIG Capital exited Brazilian chemicals maker Elekeiroz through sale to an industry leader in Brazil's specialty chemicals sector, 'H.I.G. Capital Announces the Sale of Elekeiroz to Oswaldo Cruz Química', https://higcapital.com/news/h-i-g-capital-announces-the-sale-of-elekeiroz-to-oswaldo-cruz-quimica; (2) Aqua Capital agreed to sell 100 per cent of Brazilian foodtech Puravida to Nestlé, 'Aqua Capital announces the full sale of Puravida to Nestlé Health Science', https://aqua.capital/aqua-capital-announces-the-full-sale-of-puravida-to-nestle-health-science; and (3) Advent agreed to sell Mexican Grupo Somar to Grupo Procaps, an integrated Latin American health and pharmaceutical conglomerate, 'Grupo Procaps to acquire Mexico's Grupo Somar from Advent', https://lavca.org/2022/05/17/grupo-procaps-to-acquire-mexicos-grupo-somar-from-advent.

32 According to the Global Private Capital Association's '2023 GPCA Industry Data and Analysis', the deal value of reported exits to strategic buyers in Latin America in 2022 was US$10.293 billion, which is far higher than the US$2.257 billion from public offerings and US$3.077 billion from secondary sales to financial buyers; www.globalprivatecapital.org/research/2023-global-private-capital-industry-data/.

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

Conclusion

The current challenging economic and political global context has temporarily slowed the progress of private equity and institutional investors in the region. However, many observers continue to be cautiously optimistic on the outlook for private equity investments in Latin America because the region continues to offer growth opportunities in multiple sectors.

Despite not possessing a crystal ball, we remain convinced that the long-term future of private equity and institutional investing in Latin America is bright for five main reasons:

- first, as the local economies mature, the size of the deals has grown and the capital required from private equity and institutional investors in Latin America has increased;
- second, nearshoring with the resulting general increase in M&A activity in Mexico and the positive legal reforms in Brazil and Chile are likely to continue to encourage deal activity;
- third, in time, the local capital markets in Latin America should grow and mature to provide a better path to exit private equity investments;
- fourth, private equity funds worldwide and in the region have plenty of dry powder ready to deploy[34] and will be looking for opportunities to do so, including in Latin America; and
- fifth, we believe that private equity funds and institutional investors in Latin America have developed the tools and skills necessary to operate in a highly uncertain environment, as discussed above.

There inevitably may be some issues with many investment targets in Latin America, but there are also terrific growth opportunities.

34 According to Preqin Pro, dry powder remained high in Brazil, and is one of the most important economies in the region, accounting for 23.5 per cent of total assets under management in Brazil at the start of 2022 and 22.9 per cent in mid-2022.

CHAPTER 4

Key Terms and Trends in Venture Capital Investments

Joaquin Perez Alati and Mariana Seixas[1]

Venture capital (VC), seed equity and growth-stage investing are terms frequently used to refer to investments in start-ups or early-stage businesses that usually entail significant risk, compensated by a high potential for growth and profit. Seed equity refers to investors in early-stage companies, while growth-stage investing involves companies that are more mature (by comparison), have a more developed track record and have undergone one or two rounds of seed equity funding. Professional VC investors typically contribute their know-how, networks and expertise to their targets in addition to their capital.

VC has provided much-needed capital and expertise to business entrepreneurs in Latin America in recent years, and it will likely continue to play an increasing role in the growth and expansion of companies across business sectors and countries in the region.

Unlike Latin America, the United States and other more developed markets have enjoyed a long history of VC financings, and customary practices have been developed that are particular to dealmaking in that space.

The benchmark practice in this area has been developed by the National Venture Capital Association (NVCA), which has published certain established

1 Joaquin Perez Alati and Mariana Seixas are directors at SoftBank Investment Advisers. The authors acknowledge the contributions of Jared Roscoe, at SoftBank Group International, and Stephen Pelliccia, at OpenStore, who authored the previous editions of this chapter.

forms for the suite of shareholder documents typically involved in negotiating a VC financing, including:
- the investors' rights agreement;
- the voting agreement;
- first refusal and co-sale agreements;
- certificates of incorporation or memorandums and articles of association; and
- management rights letters and regulatory compliance letters.[2]

Latin American markets, which, in other areas of law such as traditional M&A and capital markets, often negotiate and enter into 'New York-style' documents governed by New York law, have generally embraced the NVCA-style documents in connection with VC dealmaking in the region. These NVCA forms, however, are frequently tailored to account for certain regional market standards, country-specific or regional practices, and consideration for the applicable laws and jurisdictions of the investment parties and investment target. VC investors and targets work closely with local counsel in the jurisdiction of formation and operation of the target to assess when local practices and other regional considerations deviate materially from US practice.

This chapter discusses the impact of VC investments in recent years in Latin America, as well as certain key terms of the NVCA transaction agreements. Given the increased presence of large international VC investors in the region that are comfortable with the NVCA forms, an understanding of their key concepts and structures is particularly important for Latin American start-ups, those seeking to become the next Latin American unicorn and advisers that wish to efficiently help their clients achieve a successful outcome.

VC investment in Latin America

In 2016, 2017 and 2018, VC investment in Latin America totalled US$600 million, US$1.1 billion and US$2 billion, respectively, representing an almost twofold increase year-on-year. In 2019, VC investment pace increased dramatically, reaching US$5.1 billion. Following a small decline in 2020 due, in part, to the uncertainties caused by the covid-19 pandemic (but still remaining at

2 The National Venture Capital Association (NVCA) form documents were created in 2003 by a group of in-house counsel and private practitioners in the venture capital space and published on the NVCA website. Since then, the forms have been periodically updated by a working group convened by the NVCA, and additional forms have been created to address particular situations or industries. See https://nvca.org/model-legal-documents/ for the current collection of NVCA form documents.

double the aggregate investment amount of 2018), investments in 2021 jumped to US$15.9 billion. Following multiple years of exponential growth, investment activity cooled off significantly in 2022 as a result of global and regional market conditions caused by inflation, economic uncertainty, local political changes and global geopolitical turmoil. However, even though the 2021–2022 data shows that VC investment declined by almost 50 per cent year-on-year, the amount invested in 2022 continues to represent nearly twice that invested in 2020.

This data suggests that, while it may be true, as some argue, that certain investors poured capital into Latin America in an opportunistic manner in 2021 and may have since left the market, VC investing in the region became a significant practice, and it involves the collaboration of many market participants, including entrepreneurs, investors, international and local counsel, and investment banks. It is therefore important for all players to understand the main terms in the NVCA transaction documents.

Investors' rights agreement

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

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

- form S-1/F-1 demand registration rights, which enable one of more investors to force a company to consummate an initial public offering (IPO) in the United States;
- form S-3/F-3 demand registration rights for companies that are eligible for shelf-registrations; and
- 'piggyback' registration rights that allow an investor to cause a company to include shares held by the investor in a registration being carried out by the company.

Under the NVCA forms, VC financings in Latin America historically have not given investors the right to demand a company's IPO in the region. Offshore VC investors may view the local capital markets as a less attractive exit option due to the higher concentration of growth-stage companies listed on US exchanges, higher trading volumes for companies listed on US exchanges, and the more robust and investor-friendly jurisprudence that US courts (particularly in New York and Delaware) apply to commercial disputes. Consequently, registration rights in Latin American VC financings historically have not been heavily negotiated departures from the IRA form. Nevertheless, an increased presence of regional investors in VC financings, coupled with certain downward pressures that foreign exchange fluctuations and global economic uncertainty may have on stock prices, may result in an increased appetite for investors to consider demand rights for local IPOs in the future.

To ensure marketability, when negotiating registration rights it is important to ensure that these rights will be available both at the holding company level, which allows for the most efficient exit from a tax perspective and provides comfort from a governance perspective to potential purchasers, and at the operating entity level. For example, registration rights that only apply to a Brazilian operating company but not to its Delaware or Cayman parent would severely restrict the effectiveness of this type of exit for an investor. Naturally, the extent to which a target will reach the performance metrics required to launch a successful IPO in the US markets is itself analysed on a case-by-case basis and by no means has a certain outcome. That fact alone often requires significant departure from the NVCA form.

Information and observer rights tend to be more standard and less heavily negotiated, but there are certain key provisions to keep in mind. In the NVCA form, an additional classification of investor, known as 'major investor', joins the fray of investors, key holders and holders for certain purposes. The 'major investor' term sets forth a share ownership threshold over which shareholders are entitled to receive substantial information rights, including annual and quarterly financial statements, monthly financial information, customary key performance indicators and access to management. The threshold for receiving information rights is typically 5 per cent, but a lower threshold may be set to allow certain smaller institutional investors to qualify for these rights.

Many management rights letters further provide certain investors with a separate contractual right to continue receiving information rights even if they fall below the stipulated threshold and cease to be a major investor under the terms of the IRA.

A major investor could also lose its information rights if it is deemed to be a competitor by the company's board of directors. An investor-friendly approach would be to carefully define 'competitor' to prevent these rights from being capriciously removed, to expressly exclude specified investors from the definition of 'competitor' or to list in the document certain competitors of the target; the investor would become a competitor of the target if it decided to invest in any of these companies. This is particularly important given the rise of pan-Latin American companies that grow following a major investor's initial investment and negotiation of the IRA to cover a much wider geographic scope, potentially becoming competitors of other companies within the investor's portfolio. This could put the major investor in a position where a company's expansion into a new territory could trigger the 'competitor' determination and all information (and potentially other) rights would disappear.

One of the most common and important provisions in the IRA is the pre-emptive right, referred to in the NVCA agreements as a right of first offer on future stock issuances, and informally as pro rata rights. This right allows shareholders entitled to it to participate in future equity rounds in proportion to their pre-round equity ownership, and thus provide an opportunity to avoid dilution by investing more in the company. In the NVCA form, pre-emptive rights are only extended to major investors, using the same definition and sunset threshold as used for the granting of information rights. Pre-emptive rights are typically not granted to all shareholders, to limit the burden on companies raising future equity rounds. Running the process required by pre-emptive rights can entail a considerable administrative burden on the company, especially when the company is owned by a large number of investors from previous rounds. However, pre-emptive rights are mandatory in certain jurisdictions, stressing the importance of always reviewing the NVCA documents under the lens of local law and in conjunction with local counsel. In addition, institutional investors making bets on early-stage companies may ask for enhanced pro rata rights that allow the investor to take a disproportionately large percentage of the next equity round. This can be viewed by founders as a show of faith by an institutional investor or can be resisted by founders who do not wish to be wedded to the same investor in future rounds. This provision is also typically resisted by other investors that join the cap table at a later stage and push to have enhanced rights removed (which is often successful if the beneficiary of this right is not leading the subsequent round).

Finally, the IRA can also contain a variety of covenants that affect or restrict how a company operates. These provisions may include veto rights exercisable by some or all of the directors appointed by holders of preferred stock, remedial provisions arising out of due diligence, tax compliance covenants, covenants to comply with anti-corruption laws, anti-money laundering laws, data privacy laws and cybersecurity laws, and covenants to obtain a certain minimum level of directors' and officers' liability insurance coverage and customary vesting parameters for employee stock options granted in the future.

Voting agreement

The NVCA form for voting agreements binds the preferred holders, referred to as 'investors', and holders of significant portions of common stock, typically the founders and occasionally other key employees or early investors, referred to as 'key holders', to vote their shares as agreed thereunder for the election of directors nominated by a specific party and in favour of a sale of the company meeting certain criteria (i.e., a drag-along). When an investor is granted the right to appoint a director to the board of a company, the mechanism by which this is accomplished is a covenant from the other shareholders to vote their shares in favour of appointment (and removal) as instructed by the investor holding this right. The total size of the board and other significant rights related to the board and its directors, such as the list of specific decisions that require approval by the majority of the board (including, in certain cases, approval by a majority of the preference directors), is not necessarily established in the voting agreement but rather in the relevant organisational documents (certificate of incorporation, memorandum and articles of association, by-laws, etc., depending on the target's jurisdiction of formation). As such, the voting agreement will frequently not include a comprehensive description of board composition or board rights. Moreover, many important board (and shareholder) rights are established under or informed by local law, giving investors another reason to consider carefully the jurisdiction of the entity in which they are investing, as the ability to successfully enforce those rights under local law is an important protection for investors (for more on this point, see 'Charter', below). In addition to an investor's right to appoint a director, investors should carefully consider the rights founders have to appoint directors, particularly when founder appointees represent a larger portion of the board than is supported by the founders' collective equity interest in the company. The parties will seek to balance the founders' desire to maintain control over the company they have created with the investors' desire to institutionalise the company as it grows with strong governance, including through the appointment of independent directors. One way in which this balance is achieved is by requiring the founder to satisfy certain ownership thresholds or conditions such as their continued employment in the company to allow them to nominate a certain number of directors. Finally on this point, local corporate governance practices or local regulatory requirements in relation to regulated entities (which may require that a certain number of board members be citizens of the relevant jurisdiction) may come into conflict with international investors' expectations.

The drag-along right is of crucial importance to an investor, as it is the only provision in the NVCA voting agreement form pursuant to which an investor can be forced to exit its investment against its will. A drag-along right in the voting agreement form is typically triggered upon a 'sale of the company', which is often defined as a sale of more than 50 per cent of the voting power of a company or a transaction that would constitute a 'deemed liquidation event' under the company's charter or by-laws (including a sale of all or substantially all the assets of a company or a sale of all or substantially all the licences or intellectual property of a company), which is approved by the board and the requisite majority of certain holders (as further discussed below), which may include an approval threshold higher than a simple majority. Whether a drag-along right may be exercised partially may also have an adverse impact on an investor, as it could allow the dragging shareholders to drag a majority of an investor's stake, leaving that investor with an illiquid minority stake below the thresholds that would entitle it to basic rights (such as information rights or pre-emptive rights). As a result, investors will often push for the drag-along right to be 'all or nothing', meaning that they cannot be dragged unless the transaction would guarantee a full exit for the dragged investor. It is important to consider what block of shareholders can cause a sale of the company to occur and 'drag' the remaining shareholders against their will. Typically, the affirmative vote of the board, a majority or supermajority of the preferred holders, and a majority of the common holders will be required to trigger a drag. An investor may seek to protect its investment by negotiating a floor share price obtained in the sale of the company, beneath which it would not be forced to participate in the transaction (e.g., that an investor cannot be dragged if the price per share paid in the transaction is not at least twice the price paid by the investor). An investor may also seek the right not to be dragged within a certain period after the closing of its investment (typically between two and three years). Finally, an investor will look to require a preferred supermajority vote to trigger the drag so that the investor's interest in the company can exercise the maximum amount of influence, while founders will look to set the drag vote threshold below the point at which any one investor or small group of investors would have the ability to veto a sale of the company. Given the recent shift in market conditions and the limited availability of capital in the VC landscape, investors currently have greater leverage over founders than in past years, and this provision has become highly negotiated.

First refusal and co-sale agreement

The NVCA first refusal and co-sale agreement form establishes the following rights:

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

A sale of shares by key holders of more than 50 per cent of the voting power of a company may constitute a sale of the company under the voting agreement, which, if supported by the requisite shareholders, could compel the sale of the shares held by investors to the acquirer. Such a sale would also trigger the requirement in the voting agreement that the sale terms must be open to all holders of preferred stock, and the consideration offered must be structured to reflect the liquidation preferences of the classes of preferred shares of the company, thereby preserving investor value.

In some cases, the secondary right of first refusal for transfers by key holders is expanded to also cover transfers by investors. This allows investors to control the composition of the company's shareholders to limit the transfer of shares to undesired investors. This right, however, can be a double-edged sword for an investor, as it would significantly restrict the liquidity of their stake. The scope of the right of first refusal should be carefully tailored at the term sheet stage to avoid protracted discussions when drafting definitive documentation. Alternatively, a transfer restriction prohibiting transfers to sanctioned persons and persons with other issues concerning anti-money laundering and the US Foreign Corrupt Practices Act can be negotiated and included in the agreements.

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

Charter

The charter (certificate of formation or incorporation in Delaware; memorandum and articles of association in the Cayman Islands; and by-laws in most civil law Latin American jurisdictions) is one of the most important of the suite of documents to review in connection with a VC investment. The charter defines the key economic terms of the preferred shares being issued in a particular round of investment, such as the liquidation preference upon the occurrence of a deemed liquidation event, anti-dilution protection in the event of a down round, and the events that trigger a forced or automatic conversion of preferred shares to common shares. In addition, the charter typically contains preference shareholder-level veto rights referred to as 'protective provisions' that protect the key terms of the holders of preferred shares, voting together as a single class or that protect the holders of a particular series of preferred shares from modification without the consent of the requisite majority of the series or class of shares.

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

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

The liquidation preference waterfall is a highly negotiated topic. In certain cases, all holders of preference shares are entitled to receive proceeds from a deemed liquidation event on a *pari passu* basis, meaning that all preferred shareholders have the same priority in right of payment. If the proceeds of the deemed liquidation event are insufficient to pay all preferred shareholders in full, the proceeds shall be split among the preference shareholders on a pro rata basis. In other cases, particularly as companies become more mature and undergo multiple VC investment rounds, the liquidation preference may be on a per series basis, meaning that investors in the later round have priority rights to payment over investors in the earlier rounds (i.e., holders of the series D preferred shares are paid in full before the waterfall flows to the holders of the series C preferred shares, and so on).

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

The conversion mechanics in the charter allow for optional conversion by an investor of its preferred shares into common shares at any time and provide for the automatic conversion upon the occurrence of a 'qualified public offering'. The definition of qualified public offering is heavily negotiated because it is a public offering that triggers an automatic conversion of all series of preferred shares into common shares without the need for the consent of the preferred shareholders. Qualified public offerings are typically defined as an IPO with:

- a price per share offered to the public greater than or equal to a certain threshold (typically some multiple of the previous round's price per share);
- net proceeds to the company in excess of a certain threshold; and
- a listing on certain markets.

While IPOs have historically been a less likely exit from investment in Latin America than sales to strategic players or secondary funds, as increasing numbers of Latin American start-ups consummate successful IPOs, the specific components of what constitutes a qualified public offering are becoming more intensely negotiated, including to capture direct listings (in which a company becomes listed on a national exchange without an underwriting effort) and de-SPAC transactions[3] (given that the popularity of 'blank check companies' soared in 2020 and 2021, although this structure has become less utilised in recent years). The definition of qualified public offering is all the more critical as the NVCA agreements typically terminate upon the occurrence of an IPO, meaning that all of the investor's heavily negotiated contractual rights would disappear without their consent.

Debates often occur over what provisions of the NVCA agreements need to be duplicated conceptually into the charter to provide a greater degree of enforceability, particularly against third parties that are then deemed to be on notice as to the existence of these provisions.

3 De-SPAC transactions are ones in which a private company merges with an existing public shell company that was formed as a special purpose acquisition company.

Other documents and miscellaneous clauses

The NVCA share purchase agreement (SPA) functions as a typical subscription agreement with some key differences. There is no indemnity for breach of representations and warranties, although there is an ability to recover for a breach of contract. To the extent an indemnity is included (most commonly for tax and compliance liabilities in Latin American jurisdictions), it is usually handled via a side letter, and an investor should carefully negotiate the definition of 'losses' and ensure that a gross-up provision is included. The indemnity provisions typically apply after closing, when the investor will own a share in the company; therefore, in practice, the investor will be indirectly paying itself a portion of every dollar indemnified by the company. Moreover, SPAs typically do not include provisions that address risk allocation or operations of the business between signing and closing, which, in many Latin American jurisdictions, can pose problems, as competition and other regulatory approvals can result in long pre-closing periods.

Side letters may be entered into by an investor and a company to address topics that have not been covered in the other NVCA agreements. The NVCA management rights letter form includes consultation rights, inspection rights and the right to receive minutes and board material. Another concept that is often included in the management rights letter is that of investor-specific ownership sunset thresholds for the receipt of information rights that are lower than the definition of major investor established in the IRA and applicable to the other shareholders. Remedial covenants for items discovered during due diligence can also be included in the management rights letter (e.g., the execution of intellectual property assignment agreements for key employees and founders, or the transition from using independent contractors to using company employees). Because the NVCA SPA is tailored to US transactions, country-specific covenants are frequently included in side letters to avoid having to negotiate the NVCA form (e.g., covenants to comply with country-specific data protection regulations, to transition from an independent contractor workforce to using employees, or to take a different approach with respect to the tax characterisation of certain operations).

As discussed above, most of the NVCA agreements have termination provisions that are triggered by an IPO, a direct listing or a sale of the company, or pursuant to the amendment, waiver and consent provisions of each agreement. It is important to ensure that the termination and amendment provisions are consistent throughout the VC agreements to avoid ambiguities and potential disputes. Typically, the affirmative vote or consent of key holders holding a certain percentage of a company's common stock and investors holding a certain percentage of a particular series of preferred stock is required for any amendment to the NVCA agreements, but it is not uncommon to see inconsistencies across documents.

Conclusion

Almost five years after VC investing started to become mainstream in Latin America, the region has predominantly embraced the NVCA standard form documents, subject to adjustments that take into account regional or country-specific standards or practices, and consideration for the applicable laws and jurisdictions of the investment parties and investment target.

In creating these forms, the NVCA's goal was to streamline terms and documents in the VC sector, reduce costs and increase contractual certainty for both founders and investors who could look to a standard set of documents to facilitate comparisons across deals. However, there are various factors that justify the need to deviate from the standard forms, including the following considerations.

- The priorities, risk appetite and level of sophistication of each set of company founders in different industries and different countries in the region vary greatly, so an investor's approach to negotiating and documenting a transaction should also be tailored.
- As the NVCA forms address overlapping issues, there is significant potential for inconsistencies when each agreement is adapted to reflect the specific aims of the parties. Similarly, principles of risk allocation and certainty that have been adequately negotiated and documented in one agreement can be questioned or stifled by the approach to a similar topic in a different agreement, obscuring interpretation issues.
- Many of the NVCA forms are crafted with a US legal environment in mind, including the US Securities and Exchange Commission's regulations and requirements for IPOs, when in fact a vast majority of businesses operating in Latin America may not have a feasible path to liquidity via an IPO listed on a US exchange.
- Often, topics covered by the NVCA forms will have a customary or even legal treatment under the local law of the jurisdiction in which a target is incorporated or operates, requiring adaptation of the documents that are likely better addressed from precedent shareholders' agreements and by-laws, rather than via the forms.

In summary, the NVCA forms have become ubiquitous in negotiating and documenting VC investments in Latin America, particularly at the growth stage, which has contributed to contractual certainty, clearly defined and understood regional market standards and execution efficiency. Nonetheless, founders, investors and lawyers should continue to be mindful of regional and business needs that may warrant certain deviations from the norm.

CHAPTER 5

M&A Involving Family-Owned Targets in Latin America

Isabela Martins Xavier and Gustavo Deucher Brollo[1]

Generally available data points to a prevailing presence of family-held companies in the global environment.[2] Research suggests that family firms represent anywhere from 70 per cent[3] to more than 90 per cent[4] of global companies. Family companies are hardly a region-centric or contemporary phenomenon. Some of the world's oldest or most traditional companies are family owned: the Hoshi Ryokan, a hot springs hotel in Japan, has been in the same family since 718; and the Hénokiens, an association of companies that have been operating continuously, have remained family-owned, for at least 200 years, currently has 54 members, mostly from Europe and Japan.

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2 '2023 EY and University of St Gallen Family Business Index', January 2023: 'the largest 500 family businesses [in the world] generate US$8.02 trillion in [annual] revenue and employ 24.5 million people' in 47 different jurisdictions. Eleven of the world's 500 largest family-owned companies are Brazilian.

3 'Pesquisa Global de Empresas Familiares 2023', PwC and Family Business Network (FBN), July 2023, p. 4, www.pwc.com.br/pt/estudos/setores-atividades/empresas-familiares/2023/Family_Business_PUB_2023.pdf.

4 'Family Companies – To Have and To Hold', *The Economist*, 26 April 2015, www.economist.com/special-report/2015/04/16/to-have-and-to-hold.

In Latin America, it is estimated that family-owned companies represent around 85 per cent of all companies, 60 per cent of the region's GDP and 70 per cent of the private workforce.[5] They also act as financial and social anchors in their relevant communities.

Despite lagging numbers at the beginning of 2023, with a reported drop of 20 per cent in activity in comparison with the same period in 2022, M&A activity in Latin America is expected to increase, with an anticipated increase in the number of transactions in the last quarter of 2023 and into 2024.[6] Despite the political and economic risks facing the region, 80 per cent of 'investors rate their most recent large M&A deal in the region as a success on the whole'.[7] This percentage compares well to the global picture, where the average failure rate of M&A deals is between 70 per cent and 90 per cent.[8]

All M&A practitioners in the region will eventually work with a family-owned target, whether on the buy-side or the sell-side, as M&A activity within this space has increased and become more profitable. M&A deals with family-owned targets involve added layers of complexity no matter where in the world they occur. In Latin America, counsel must be familiar with the sociocultural, as well as the technical, aspects of the deal.

The term 'family-owned company' tends to evoke images of small enterprises. However, family-owned targets in Latin American M&A often involve some of the largest and most thriving businesses in the region, in which a single family may exercise both ownership and control.

In these firms, corporate governance may be anywhere from well-established to non-existent. Non-professional management and lack of corporate governance structures that are commensurate to the size and operations of the company create negotiation challenges not only for the company itself but also for all

5 FBN, 'International Finance Corporation Family Business Governance Handbook', www.ifc.org/content/dam/ifc/doc/mgrt/family-business-governance-handbook.pdf.

6 Daniel Salazar Castellanos, 'M&A Activity In Latin America Seen Picking Up In Second Half', Bloomberg, 18 August 2023, www.bloomberglinea.com/english/ma-activity-in-latin-america-seen-picking-up-in-second-half/.

7 KPMG 2023 M&A in Latam Survey, 'In an uncertain world, Latam M&A is on the rise', June 2023, available at https://kpmg.com/xx/en/home/insights/2023/06/kpmg-2023-m-and-a-in-latam-survey.html.

8 'The Big Idea: The New M&A Playbook', Harvard Business Review, 2011, available at https://hbr.org/2011/03/the-big-idea-the-new-ma-playbook.

stakeholders. In the context of an M&A transaction, weak corporate governance[9] may negatively impact negotiation of the deal terms and the development of the due diligence process and may even result in a reduced company valuation.

Family-owned companies are usually a centre of economic activity in the region in which they are established, and owner families tend to be very concerned about their reputation and social responsibility. The confidentiality of the transaction is paramount. Further, the family may need to be convinced that the business will continue at least in the same manner in which it has operated to date.

Many family firms do not have succession plans in place. Family dynamics play a critical role: which family members have more power? How entangled are the family and the company's financial matters?

This chapter addresses the above factors and inherent levels of complexity in M&A deals involving family-owned targets in Latin America in three sections: understanding the target, deal management and post-closing considerations.

Understanding the target

Any M&A deal needs a clear and compelling rationale. Families – justifiably – tend to be attached to their businesses. A decision to sell the business therefore generally requires a much stronger motivation than to keep it. Some reasons to sell are based on factors that are hard to change, such as a pressing need for liquidity or to solve or avoid a family conflict. Other reasons are more variable: the current generation no longer identifies with the family business, opportunity (chance of a lifetime) or increasing competition.

All businesses have life cycles and, because of the frantic pace in which the Latin American economy has been changing in recent years, these life cycles have become shorter and less predictable. A company that is competitive and innovative at one point in time may need additional technology, capital and talent to remain so. The family may not be able or willing to pool the necessary resources to continue as a significant player in its relevant market. And it is of course more strategic to sell the business before it becomes worthless. Further, if a certain industry is consolidating, the family should not be the first or the last to sell but should have the business acumen to selling at the right point in time to maximise value.

9 'Pesquisa Global de Empresas Familiares 2023', op. cit.: 22 per cent of interviewed families believe that family discord is the greater challenge to building stakeholders' trust (in Brazil, that rate is higher, at 26 per cent).

Families also naturally change over generations, and the new generation may simply not be interested in continuing the family business.[10] Families sometimes use the proceeds from the sale of their original business to start up or buy another business, as research and studies have shown.[11]

Finally, considering the economic and political cycles in the region, families should take into consideration that a good deal may not be on the table for a long period of time. Timing is not an insignificant factor anywhere, but it is especially important in Latin America.

Framing the sale of the family business as a strategic, timely manoeuvre, and as proof that the family enterprise has been successful enough to attract a potential buyer, may help dissuade negative reputational concerns in the owner family. Under the right terms, selling the family business may be the best plan for the continuation of the business; it may enable family members to pursue new business ventures and solve family disputes regarding succession or internal power struggles.

Counsels should also keep in mind that family-owned companies are not institutional investors and their decision-making process is usually slow and protracted. During negotiation, it helps to put delays in perspective and identify moments when pressuring the seller is not advisable and may have a contrary effect. An M&A with a family-owned target may take much longer than a 'corporate player' deal and could require more tact, diplomacy and patience.

When mapping out the target, it is helpful to identify who the true decision makers in the family are, and how the other members behave in relation to them. The family usually indicates (expressly or tacitly) one member who will act as their representative in negotiations. Nevertheless, it is not rare to find that the family members do not fully agree with each other, and counsel may have to explain the same deal terms to several family members on separate occasions, taking into consideration the level of legal or negotiation expertise of each member. The deal terms should only be considered as 'agreed' once there is unequivocal proof that

10 Research conducted in Brazil by the Dom Cabral Foundation, 'Pesquisa Médias Empresas de Alto Crescimento: um recorte das empresas de controle familiar', published in September 2022, concluded that family companies are largely formed by first and second generations. Among the middle-market family-owned businesses considered in the research, 46.9 per cent were first-generation businesses, 43 per cent were second-generation businesses and only 10.1 per cent were third-generation businesses. This illustrates the difficulties faced by family-owned companies in achieving longevity.

11 Northern Trust, '2022 Business Owner Benchmark Report'; Coutts & Co, 'Life After Exit', 2012; Denise Kenyon-Rouvinez, 'Patterns in Serial Business Families: Theory Building Through Global Case Study Research', *Family Business Review* (2001), Vol. 14, Issue 3.

the controlling members have granted their consent and that the minority stakeholders will not oppose the deal.

Understanding the target means understanding not only how the company operates, but also the family behind it. The more knowledge a potential buyer can garner of the company and the family, the easier it should be to gain the family's trust. And every counsel will agree that it is much easier to negotiate from a place of trust.

In that same vein, in Latin America it is standard for business families to have one lawyer who has been close to the family for a long time and who knows the family and the business better than anyone. They are not usually versed in M&A transactions but can be a formidable asset when working together with specialised M&A counsel. Gaining the family's trust may well depend on combining forces with the family counsel or in some instances even deferring to their knowledge of the family and the business despite their lack of M&A-specific expertise.

Deal management

The typical M&A timeline and pace will likely come as a surprise to the family if it is their first transaction. Counsel should not assume that the M&A standard terms and procedures are common knowledge, and they should be easy to approach for clarifications at any time during the deal. Deals often take much longer, involve much more effort and interfere more with the company's daily operations than a family business may anticipate.

A sensible starting point would be for counsel to provide the family with an overview of the deal's anticipated timeline (non-disclosure agreement, memorandum of understanding, due diligence, signing, closing and post-closing), as well as of the main terms that will be reflected in the transaction documents. The target will be more comfortable knowing how much effort will be required and the best opportunities for smoothing out any sticking points during the negotiation. Sellers will likely be keen to learn that most purchase agreements provide for a signing date, an interim period to fulfil conditions precedent (when any regulatory approvals should be obtained) and a closing date.

There is ample reason for hiring an expert M&A counsel at the early stages of the transaction, preferably before executing any preliminary documents. Although preliminary documents are rarely binding in their entirety, their provisions set the tone for the remainder of the transaction. If sellers commence the deal at a disadvantage, it is harder to reverse positions in the course of the deal.[12]

12 See the 'Preliminary Legal Documents in Mexican M&A Transactions' chapter in this guide.

A major hurdle in Latin American transactions is the due diligence phase. Forty-three per cent of companies and investors in the region do not consider themselves 'good' at this process.[13] Investors find that it is hard to source reliable financial information, such as historical revenues and projections, or to assess the business's internal controls and accounting policies. Foreign investors, in particular, understand that the rule of law is an issue in Latin American countries: they view judicial decisions as reversible to some degree and the judiciary as politicised, and they question the enforceability of contracts. In Brazil, tax rules are voluminous, very specific, ever-changing, challenging to observe and difficult to navigate.

Family business particularities only add to the regional woes of conducting satisfactory due diligence. From an 'owner's pride' perspective, it is not easy to admit that certain of their business practices are not satisfactory, that some of the decisions made by the family were inadequate or that their record-keeping is less than ideal. Management may be uneasy in disclosing known liabilities, fearing that they may reflect badly on their personal performance. Many due diligence queries seem excessive or unimportant to sellers. In addition, sellers may prefer not to reveal certain contingencies, fearing that they might subtract from the company valuation.

Furthermore, a due diligence process is highly disruptive to the company's operations. The required secrecy of the transaction implies that only a handful of employees are privy to the process and must spend valuable time gathering documents and disclosing information while still performing their daily duties.

The role of M&A counsel during the due diligence process is multifaceted. First, it is important to explain how the process works, that the company should provide the fullest set of documents possible, in the most organised manner, and that it should be open to an honest discussion when it believes that a certain query is not applicable or should offer an explanation when a certain document or information is simply not available. Thorough disclosure builds trust between the parties, avoids misrepresentation on the part of the sellers (and the triggering of potential post-closing indemnification obligations) and allows the parties to negotiate the best possible treatment for contingencies at an earlier point in the deal. The due diligence process may even help the company assess certain matters that may be dealt with or mitigated prior to signing. It is not rare for the company itself to benefit from the results of a detailed due diligence.

13 KPMG 2023 M&A in Latam Survey, op. cit.

Counsel may further help with the actual organisation of the flow of information and documents, identifying repeated requests, pointing out when certain information or documents provided under one demand may fulfil another request, holding frequent status meetings, setting up the actual data room and assisting the company in obtaining or preparing documents not readily available (such as court certificates, lawsuit reports or expired permits).

It has recently become more common for M&A counsel to assist the target company by preparing a vendor due diligence report, which provides a useful 'handbook' to the sellers and the company, covering tips on housekeeping prior to the buyer performing its due diligence, which will help the company to adequately address the buyer's diligence queries and anticipate negotiation issues, including by providing organised information in easy-to-find format, with clear language, which helps avoid misunderstandings and speeds up the process from the buyer's standpoint. It presents the company with an opportunity to discover or discuss existing contingencies and present and strategise viable solutions or mitigation measures ahead of the buyer's assessment.

Another common role for counsel during the due diligence process is to help assess the risks corresponding to the identified contingencies, and advise on how to mitigate or allocate them in the transaction documents. Risk analysis and contractual provisions addressing these risks may result in a lower discount in the company's valuation or lower amounts set aside in escrow to guarantee future indemnification against materialisation of contingencies post-closing. Close interaction with and easy access to financial and accounting advisers facilitate legal counsel's risk assessment duties.

Finally, when preparing the company for scrutiny by the buyer's advisers, M&A counsel may be faced with an overly common aspect of family-owned business: the entanglement between the company's and the family's financial affairs. Assets that are extraneous to the business and mostly used by the family should be transferred or spun out of the company (for example, real estate properties or vehicles). Conversely, assets that are owned by family members but should belong to the company must be transferred to the company; this is especially common in technology companies in which certain intellectual property has been developed by the founder but not properly registered as company property. Related-party agreements should be reviewed:

- Are the prices, terms and conditions at arm's length?
- Would the agreements remain in place after the closing of the transaction?
- Have any family members provided or obtained loans from the company?
- Have family members entered into agreements to guarantee company obligations or vice versa?

Ideally, the full separation of family and company matters should be achieved before signing the transaction documents. Most commonly, however, counsel will assist the family in devising the best solution for each situation.

Family-owned companies may be very adept at doing business and even at negotiating agreements, but they will probably lack familiarity with M&A-specific agreements. Therefore, it is important to allow the family members adequate time to review and understand the contract terms. At the same time, the deal should not 'lose traction' as most buyers expect a speedy process. Consequently, it is incumbent upon the family-owned target's counsel to help the family find the time to educate itself on the contract terms. Scheduling frequent and successive document review sessions and strategy meetings with the family, while providing regular feedback to the buyer, is a time-proven manner in which to achieve a comfortable pace for most.

When negotiating the transaction agreements, family-owned companies will also be faced with foreign (often anglicised) contractual terms and structures and an unfamiliar set of detailed representations and obligations on the seller's side. Counsel's primary role is to explain the reason for, and consequence of, each of these terms so that the sellers feel comfortable in undertaking the obligations and providing the representations or, conversely, refusing these terms and conditions. Transparency and expertise are paramount. While counsel may be tempted to assure their clients that all their requests and demands are reasonable, a more productive approach is to explain which terms and conditions are standard and whether it is worth negotiating a deviation from customary terms and conditions, as well as helping clients differentiate between 'nice to have' and 'deal breaker' requests.

To that effect, one of the most important elements to be negotiated in the transaction agreements are the seller's pre-closing indemnification obligations. The expectation of sellers is usually to sell the company, cash the purchase price and never look back. In reality, however, the large majority of private M&A deals are entered into with indemnification obligations or some other buyer recourse. This negotiation aspect may be difficult for sellers to process. When faced with a post-closing indemnification obligation, most sellers will pay out of their personal assets. However, by refusing to accept standard indemnification obligations, sellers may alienate a potential buyer or risk a significant discount in the purchase price.

It is common to negotiate limitations to the sellers' obligations to indemnify the buyer. For example, indemnification obligations may be limited in time (i.e., for a limited survival period after the closing, as opposed to the statute of limitations), in amount (i.e., a cap in the total amount to be indemnified) or to certain types of damages (e.g., no indirect damages or loss of profits will be indemnified). These provisions usually help sellers become more comfortable with the concept of post-closing indemnification and should be explained in detail by counsel.

In the spirit of helping a family-owned business navigate an M&A deal, counsel should be available to assist with the completion of conditions precedent to closing. Certain conditions precedent will require legal work, such as obtaining antitrust clearance or regulatory approval. Other conditions precedent, however, will not be reliant on lawyers, such as certain third-party consent. Nevertheless, counsel should follow up on the completion of all conditions precedent, so as not to jeopardise the parties' efforts to close the deal. Further, it is important to advise the sellers to operate the company as normal between the signing and closing periods. Any company activity deviating from past business practice should be avoided.

Post-closing considerations

Once counsel has successfully assisted a family-owned business in concluding an M&A deal, and the relevant parties have happily closed the transaction, counsel's work is still far from over.

The family will likely require counsel's assistance with tax and wealth planning to secure and maximise the results of the sale. Certain corporate structures must be devised and set in place ahead of the closing so that the proceeds may be immediately transferred to a specific fund or entity. Sellers may also hire financial consultants to assist with diversification of investments, and counsel should be available to advise on the legal aspects of the suggested investments.

It is also common for a seller to be asked to remain in the company after the sale, as a consultant, an officer or even as an employee. This arrangement may benefit both the seller and the buyer: the buyer retains the seller's business expertise and managerial influence, whereas the seller can count on an additional income stream and purpose. The experience may also help the seller gradually transition out of the business that they built.

This arrangement does not come without its costs, however. The parties' expectations should be clearly reflected in the relevant agreement: the duties to be performed by the seller shall be exhaustively listed, as should the benefits they will receive in consideration. The seller's role must be clear in terms of the amount of time that should be dedicated to the company and whether exclusivity is required. If ensuring that a seller's specific knowledge being transferred to the company is a concern, the agreement should also contain specific milestones to be fulfilled by the seller as a condition for receiving remuneration.

Many deals set forth that part of the purchase price will be paid as an earn-out instalment, contingent on the achievement of certain performance targets by the company. When accepting contingent value payments, sellers should be aware that earn-out instalments are not guaranteed. Many sellers operate under the assumption that, by remaining in the business (although no longer as owners), they can make sure that the performance targets will be achieved. However, the seller's level of influence on the company performance after the sale is hardly comparable to the level of influence they would once have had. Also, many external factors impact the achievement of targets. The important point to make is that earn-outs are not certain. They can, however, be negotiated to include as many objective criteria as possible, while the sellers should aim for agreed targets that may be achievable even if the company does not operate consistently with past business practice.

In deals in which the family does not sell the entirety of the business, the post-closing period is even more important, for the buyer and founders must co-exist as shareholders in the same enterprise. It is imperative that the parties negotiate a shareholders' agreement that will govern their rights and obligations as partners in the business. The shareholders' agreement typically provides the following:

- rules on governance;
- quorums required for approval of certain decisions within the company;
- investment policy;
- dividend distribution; and
- conflict resolution provisions.

One of the most important roles of the shareholders' agreement is to set forth the exit strategies in advance, including: how a shareholder may buy additional shares or sell their own shares to another shareholder; when one party may force the other to jointly sell their shares to a third party; and how the shareholders should decide on a public offering.

Negotiating a shareholders' agreement may prove more challenging than negotiating the actual sale of the shares. It is usually difficult for the founding family to relinquish their controlling position while remaining in the company – watching the daily operations but not calling the shots. It is also difficult to anticipate scenarios in which the family may be forced to sell its remaining participation for a predetermined price (call-option or drag-along provisions are common features). However troublesome or delicate the negotiation of a shareholders' agreement may prove to be, it is not a contract that should be taken lightly. It will remain in force for several years and will guide the parties' interactions long after the closing, as well as determine the ability of the sellers to fully exit a business that they may no longer control.

Conclusions

An M&A practitioner has a slim chance of never working with a family-owned target in Latin America, regardless of the side that they may be advising. Regardless of the party (buyer or seller) that they may be advising, the same challenges will be present, as two sides of the same coin. A keen understanding of these challenges and a strategic plan to deal with them are the best tools for achieving a satisfactory outcome for the clients.

M&A deals with a family-owned target require more than technical expertise from the involved counsel. The business owners will most likely be unfamiliar with the M&A process, expressions or agreements. They will probably be introduced to a new M&A expert counsel whom they will have to trust and confide in. They will be decoupling the family identity and values from the business. Many sellers will be relinquishing the work and purpose of a lifetime. The family decision-making process may be protracted and convoluted. The business is unlikely to be ready for sale and will require corporate reorganisation and other legal measures to disentangle family assets from business assets. These aspects should not be ignored or regarded as anomalies but planned for and dealt with with diplomacy, patience and transparency. Counsel will do well to adopt an organised, open-minded and proactive approach and to make sure that communication is frequent and clear on both sides of the table.

Counsel's technical skills and expertise are essential in adequately negotiating and reflecting the parties' expectations, rights and obligations in the transaction agreements. The transaction may be concluded in less than a year, but its effects will last for much longer. The parties will continually look up to the relevant agreements as a faithful record of their intent and agreement.

CHAPTER 6

Privatisations in Colombia and M&A Transactions with Government Entities

Lina Uribe García and Juan Pablo Caicedo De Castro[1]

Successful completion of M&A operations directly involving entities owned or controlled by a country's government or governmental agency as a transactional counterparty has always been a difficult and burdensome task in Latin America. Complex legal frameworks, political struggles and a high degree of legal exposure and liability for the public officials undertaking these transactions have been constant obstacles to prosperous development of this particular field of M&A practice. However, globalisation and the eruption of neoliberal democracies[2] in Latin America after the Washington consensus triggered an increasing trend to privatise state-owned companies.[3] Economic data reflects that Latin America accounted for an estimated 55 per cent of total privatisation revenues in the developing world in the 1990s.[4] Moreover, as the business environment in Latin

1 Lina Uribe García is a partner and Juan Pablo Caicedo De Castro is a senior associate at Gómez-Pinzón. The information in this chapter was accurate as at October 2022.

2 Lora, E, 'Structural reform in Latin America: What has been reformed and how it can be quantified' (updated version), IDB Working Paper Series, No. IDBWP-346 (Inter-American Development Bank, 2012), available at: www.econstor.eu/bitstream/10419/88956/1/IDB-WP-346.pdf (accessed on 17 May 2021). See also Vergara Estévez, J, 2005, 'El mito de las privatizaciones en Chile', *Polis Revista Latinoamericana* (En línea), 12 | 2005, published 17 August 2012, available at: http://journals.openedition.org/polis/5604 (accessed 16 May 2021).

3 Chong, A and López-de-Silanes, F, 2005, 'Privatization in Latin America: Myths and Reality', in *The Truth about Privatization in Latin America* (Stanford Economics and Finance and The World Bank), p. 1, available at: https://publications.iadb.org/publications/english/document/Privatization-in-Latin-America-Myths-and-Reality.pdf (accessed 16 May 2021).

4 id., p. 5.

America continues to evolve and markets become fiercely competitive, it is inevitable that governments increasingly use the sale of public assets or state-owned companies as means to obtain liquidity and successfully exit highly demanding and cash-intensive operations they are no longer able to run efficiently.[5] Even prior to the outbreak of the covid-19 pandemic, the sale of assets has served as a useful mechanism for governments and public entities to obtain the financial resources required to strengthen their budget, reduce fiscal deficit, improve sovereign debt ratio and undertake major projects of public welfare.[6]

The highly publicised *Isagen* case in Colombia,[7] which finally closed in January 2016 after years of political and legal struggles, is a revealing and useful example of the degree of complexity and uncertainty to which privatisations are subject. The transaction was of the utmost importance for the government, as the resources derived from such operation would be destined for the implementation and funding of a new generation of toll road programmes in Colombia.[8] Yet, it took more than eight years for the Ministry of Finance to successfully complete. Similar difficulties have been observed in other Latin American jurisdictions such as Uruguay, Argentina, Brazil and Chile.[9] Notwithstanding its troublesome nature, it can be expected that the fiscal deficit derived from the economic challenges entailed by the covid-19 pandemic[10] will act as a driving force in the increasing trend of privatisations and M&A with government entities for the foreseeable

5 See Boardman, A and Vining, A R, 1989, 'Ownership and Performance in Competitive Environments: A Comparison of the Performance of Private, Mixed, and State-Owned Enterprises', *Journal of Law and Economics* 32: 1–33. See also Huizinga, H and Bo Nielsen, S, *Privatization, public investment, and capital income taxation* (Elsevier Science, 2001), p. 399.

6 Gonzalez III, J and Kemp, R, *Privatization in Practice: Reports on Trends, Cases and Debates in Public Service by Business and Nonprofits* (McFarland, 2016).

7 The Ministry of Finance started to analyse the potential sale of its 57.66 per cent equity stake in major hydroelectric energy generator Isagen SA ESP in 2008. The financial and legal advisers engaged by the Colombian government began structuring the operation in 2009 (see 'The Isagen case', below, for further information on this deal).

8 See http://es.presidencia.gov.co/columnas/minhacienda/los-recursos-de-isagen-motor-para-la-infraestructura-del-pa%C3%ADs (accessed on 16 May 2021).

9 *Foreign investment in Latin America and the Caribbean* (United Nations, 2002).

10 Frankel, J, *The Impact of the Pandemic on Developing Countries* (Harvard Kennedy School, 2020).

future, particularly in certain Latin American jurisdictions with conservative or neoliberal governments in office.[11] Hence, fully understanding its complexities and having a grasp of the main issues has become paramount for M&A practitioners.

This chapter explores the main challenges faced when undertaking M&A transactions involving the government or government-owned entities, with a particular emphasis on privatisations in Colombia. The first section of this chapter contains a general overview of the legal framework applicable to the various types of M&A operations involving government entities, and identifies the main legal and transactional issues derived therefrom. The second section seeks to provide practitioners with an in-depth analysis of how some of these issues have been successfully tackled in previous privatisations. The third section analyses the current economic environment amid the covid-19 pandemic and how this situation can potentially impact M&A transactions with public entities.

The legal framework

M&A operations in Colombia involving government entities,[12] also referred to as public entities, can be subject to different legal regimes, depending mainly on (1) the transactional role being assumed by the public entity and the specific type of asset being sold; (2) the legal nature and contractual regime of the public entity undertaking the transaction; and (3) the legal nature of the counterparty (public entity or private party). Properly identifying the applicable rules to the potential deal is a fundamental matter from a structuring perspective.

If the public entity is acting as seller of an equity interest to a private party, generally such process will qualify as a privatisation and, as such, shall abide by the rules and principles applicable to this type of operation. If the public entity is acting as buyer in an M&A transaction or if the sale encompasses assets different than equity interests, most likely the transaction will not be covered by privatisation rules but rather by the specific contractual regime applicable to the relevant public entity. If the M&A operation is not covered by privatisation rules, the legal

11 Customarily, left-leaning or socialist political parties are opposed to the privatisation of state-owned companies. It can be reasonably expected that Latin American countries with this type of government in office do not experience a rise in the field of privatisations within their M&A markets.

12 Under Colombian Law, state entities (*entidades estatales*) are those encompassed by Article 2 of the Colombian Public Procurement Statute (Law 80 of 1993, as amended from time to time), Articles 10, 14 and 24 of Law 1150 of 2007 and all other entities that legally shall abide by public procurement rules. See https://www.colombiacompra.gov.co/ciudadanos/glosario/entidad-estatal (accessed on 17 May 2021).

nature of the public entity shall determine the rules applicable to the potential M&A transaction. For instance, most state-owned companies in Colombia[13] have a contractual regime under private law rather than under general public procurement laws.[14] M&A transactions that do not qualify as privatisations and that involve government-owned entities governed by private law can usually be structured under private law, which significantly facilitates the likelihood of a successful closing. On the other hand, certain government entities like state organs[15] are typically subject to regular public procurement rules or to special contractual regimes[16] that could affect M&A operations falling outside the scope of privatisation rules. Furthermore, if the target entity is a listed company and privatisation rules are not applicable to the operation, securities regulations regarding mandatory tender offers will need to be observed. Finally, the legal nature of the public entity's counterparty in the transaction is also relevant for determining the applicable legal framework. For instance, sales of equity interests among public entities are generally excluded from privatisation rules and are usually implemented through inter-administrative agreements under public procurement laws.[17]

In Colombia, following the adoption of the Constitution of 1991, major privatisation regulations were adopted through the enactment of Law 226,[18] which further develops the fundamental concepts contained in Article 60 of the 1991 Constitution. Particularly, this provision contains the principle of democratisation of state-owned equity interests, and grants a preferential right to workers, unions and the 'Solidarity Sector'[19] to purchase the equity participation being sold

13 Namely mixed-equity companies (*sociedades de economía mixta*) and industrial and commercial state companies (*empresas industriales y comerciales del estado*).

14 Article 461 of the Colombian Commercial Code, available at: www.secretariasenado.gov.co/senado/basedoc/codigo_comercio_pr014.html#461 (accessed on 17 May 2021).

15 Such as ministries, government agencies and territorial or regional entities.

16 For instance, the sale of assets seized by the Colombian government as a consequence of criminal activities (*extinción de dominio*) is regulated by Law 1708 of 2014 and Law 1849 of 2017, available at www.secretariasenado.gov.co/senado/basedoc/ley_1708_2014.html and www.secretariasenado.gov.co/senado/basedoc/ley_1849_2017.html, respectively (accessed on 16 May 2021).

17 See Article 2.4 of Law 1150 of 2007, available at www.secretariasenado.gov.co/senado/basedoc/ley_1150_2007.html (accessed on 17 May 2021). See also Article 20 of Law 226 of 1995, as referenced in footnote 18 of this chapter.

18 Law 226 of 1995, available at www.secretariasenado.gov.co/senado/basedoc/ley_0226_1995.html (accessed on 17 May 2021).

19 'Solidarity Sector' includes employees, pensioners and former employees of the target entity, employees' associations, unions, pension funds and similar organisations.

under special and more favourable conditions than regular market investors or buyers.[20] On these grounds, Law 226 laid down the basic principles and procedural rules under which a privatisation in Colombia must take place. From a dealmaking perspective, some of the main structural challenges for the successful completion of privatisations in Colombia derive from this regulatory framework and the legal and practical complexities it can entail.

Rules of the game

Privatisation regulations in Colombia encompass partial or total sales to private parties of state-owned equity interests or mandatory convertible bonds. State ownership will be deemed to exist when the specific equity participation is held either directly or indirectly by a public entity, or when it was acquired using public funds or funds from the public treasury.[21] There are certain specific situations that constitute exceptions to the application of Law 226, such as:

- the sales of equity interests to other government entities;[22]
- M&A or general commercial transactions not consisting of the sale of equity interests;
- sales of equity interests outside of Colombia;[23] and
- mandatory or non-voluntary sales of equity interests.[24]

The first three exceptions are straightforward and should facilitate substantially the legal structuring of M&A operations with public entities as sellers. However, identifying mandatory or non-voluntary sales can be troublesome, as the legal grounds for such situation are not clearly distinguishable in the applicable laws or appear in an ambiguous or controvertible manner, often providing insufficient basis and lack of certainty to determine whether the exclusion of Law 226 is

20 See Ruling C-1260 of 2001 from the Colombian Constitutional Court (Corte Constitucional), Justice Rodrigo Uprimny Yepes, available at: https://www.corteconstitucional.gov.co/relatoria/2001/c-1260-01.htm (accessed on 19 May 2021).

21 Article 1 of Law 226 of 1995.

22 Article 20 of Law 226 contains a special exception to the applicability of Law 226 for sales of shares between state organs (*órganos estatales*). Namely, this provision establishes that sales of shares between these types of entities will not be subject to the rules of Law 226 of 1995, but to the relevant rules of public procurement in force at the time in which the operation takes place.

23 See Concept 2314 of 15 December 2016 of the Consultation and Civil Service Section (Sala de Consulta y Servicio Civil) of the Colombian Council of State (Consejo de Estado).

24 See Concept 1513 of 9 October 2003 and Concept 1827 of 7 June 2007 of the Consultation and Civil Service Section of the Colombian Council of State.

applicable, especially exposing the transaction to potential challenges from the Solidarity Sector and supervisory government entities in Colombia.[25] In certain cases, the applicability of the Law 226 exclusion on the basis of mandatory sales can be forthright, for instance if there is an unappealable decision by an administrative or judicial body ordering the divestiture. In this scenario, the Colombian Council of State[26] has clearly identified such situation as grounds for excluding the application of Law 226. However, other scenarios such as industry-based regulations not allowing for certain kinds of investments to be made in a given market or imposing thresholds on cross-investments in sector-specific supply chains (e.g., restrictions on permitted investments for financial entities[27] or regulatory restrictions to avoid anticompetitive effects in certain markets such as gas,[28] energy and public utilities) can be harder to defend as grounds for a mandatory M&A deal that excludes the application of Law 226, considering that excluding privatisation rules in these cases will be unilaterally assessed by the selling entity and will not derive from a judicial or governmental order. An incorrect assessment of this matter can entail critical consequences, as M&A transactions that should abide by Law 226 in Colombia and are performed outside of such legal framework will be deemed as null and void under Colombian Law.[29] Thus, analysing if the intended transaction falls under privatisation rules is one of the first tasks to be performed by legal advisers, as such assessment will strongly dictate the possibilities of successfully closing the deal and the timeline for its execution.

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25 Namely, the Comptroller General of the Republic (Contraloría General de la República), the Colombian control agency that oversees the proper administration and execution of the public budget and public funds, and the Public Ministry (Procuraduría General de la Nación), responsible for protecting fundamental rights and guarantees of citizenship and of imposing disciplinary action against public officers and servants.

26 Consejo de Estado, maximum court for administrative law matters.

27 See Articles 110 and 119 of Decree 663 of 1993 or Organic Statute of the Financial System (Estatuto Orgánico del Sistema Financiero), available at: http://www.secretariasenado.gov.co/senado/basedoc/estatuto_organico_sistema_financiero.html#1 (accessed on 17 May 2021).

28 See Resolution 057 of 1996 issued by the Colombian Regulatory Commission on Energy and Gas (Comisión Reguladora de Energía y Gas), available at: http://apolo.creg.gov.co/Publicac.nsf/Indice01/Resoluci%C3%B3n-1996-CRG57-96 (accessed on 17 May 2021).

29 Articles 14 and 15 of Law 226 of 1995, available at www.secretariasenado.gov.co/senado/basedoc/ley_0226_1995.html (accessed on 17 May 2021). See also Ruling 11001-31-03-028-1997-09465-01 of 30 October 2019 of the Colombian Supreme Court of Justice (Corte Suprema de Justicia), Justice Aroldo Wilson Quiroz.

Basic principles

Law 226 establishes four guiding principles that must be observed when undertaking privatisations in Colombia. The legal effects and practical implementation of these principles can have a major impact on various aspects of the transaction – mainly on its legal structuring, the standard of review of the due diligence process and the bidder selection mechanism. These principles can be summarised as follows.[30]

- Democratisation: this seeks to guarantee that all individuals and legal entities are allowed to have access to the equity participation that is being sold in the privatisation process. To accomplish this goal, it imposes an obligation on public entities acting as seller to implement mechanisms of wide publicity and free competition throughout the sale process.[31] In practice, this principle prevents the public entity acting as seller to unilaterally hand-pick the final buyer and requires the implementation of mechanisms that allow all potential and admissible bidders to participate in the privatisation process.
- Preference: pursuant to this principle, all privatisation processes must exhaust a mandatory two-month stage under special conditions, destined exclusively to the Solidarity Sector. This principle stems from the basic concept contained in the aforementioned Article 60 of the Constitution.[32]
- Protection of the public treasury: by virtue of this principle, the public entity acting as seller must act with extreme caution throughout the privatisation process and must deploy commercially reasonable efforts to sell the equity participation at a price that does not entail a detriment to the public treasury, which accurately reflects market conditions and the specific characteristics of the underlying asset.[33] The proper observance of this principle is one of the most highly scrutinised points by the Comptroller General in Colombia.
- Continuity of service: during a privatisation process involving the sale of a company that provides a public service, the public entity acting as seller must guarantee the continuity of these public services, which shall not be affected by the potential transaction.[34] On the grounds of this principle, many privatisation operations in Colombia have implemented a pre-qualification

30 See Concept 1663 of 28 July 2005 of the Consultation and Civil Service Section of the Colombian Council of State.
31 Article 2 of Law 226.
32 id., Article 3.
33 id., Article 4.
34 id., Article 5.

phase for potential buyers,[35] which seeks to verify that only investors that have the capacity and technical expertise to operate the target company without affecting the continuous supply of the public service can participate in the final stages of the sales process.

The roadmap

Law 226 requires the public entity acting as seller in the privatisation process to design a sales programme for the equity participation being offered. This document constitutes the basic legal framework for the specific transaction being pursued and must include, at least, the following elements:

- the stages in which the privatisation process will take place, including the mandatory and preferential two-month phase destined to the Solidarity Sector;
- the special conditions destined exclusively for the Solidarity Sector;
- payment structure and conditions; and
- minimum price per share of the target entity, which shall be a fixed price throughout the offer to the Solidarity Sector.[36]

The sales programme is customarily adopted through a decree issued by the public entity pursuing the privatisation and provides a limited time span to complete the transaction. Additionally, the sales programme usually delegates on a corporate organ, committee or person the faculty to issue special regulations for each phase of the privatisation,[37] which include the detailed legal and operational aspects of the transaction.

From a contractual perspective, privatisations in Colombia have a very particular structure. Typically, no purchase agreement is negotiated between the selling government entity and the purchaser,[38] and the company or equity interest is sold 'as is'. Thus, the transaction documents will not include customary M&A provisions such as representations and warranties or indemnity rules in favour of the purchaser. In cases of mandatory application of Law 226, the transaction will

35 The legality of pre-qualifications has been ratified by the Colombian Council of State. See Ruling of 9 March 2017 of the Fourth Section of the Contentious Administrative Law Matters Chamber (Sección Cuarta de la Sala de lo Contencioso Administrativo) of the Colombian Council of State, Justice Jorge Octavio Ramírez.

36 Article 10 of Law 226.

37 Usually called Reglamentos de Enajenación, which form an integral part of the sales programme.

38 Even though a formal written purchase agreement is not negotiated and executed, the essential elements for the formation of a basic purchase agreement under Colombian law will be fulfilled.

be necessarily governed by Colombian law, excluding the possibility of convening a different legal regime as the applicable law.[39] Additionally, from a dispute resolution perspective the sales programme of each privatisation usually grants jurisdiction over the process to Colombian courts and tribunals.

Regarding seller's liability, Law 226 does not contain any specific provisions regarding this matter. As mentioned, the general rule in privatisations is that the company or equity interest is sold 'as is' and no representations and warranties or indemnity rules are granted in favour of the purchaser. However, this legal structure should not be construed as granting sovereign immunity or other figure of similar nature. Under the 1991 Constitution, the government shall be liable in cases in which unlawful damages or losses are caused by acts or omissions of a public authority.[40] Furthermore, the Colombian Council of State has recognised that public entities acting as sellers in privatisation operations also must abide by the good faith principle,[41] which encompasses the duty of disclosing material information to a counterparty in the pre-contractual stage of negotiations. In privatisations, this duty also stems from the free competition element of the democratisation principle.[42] Colombian public entities such as the Ministry of Finance have been held liable and forced to indemnify buyers that have suffered damages in privatisation operations as a consequence of the government's disregard for the good faith and democratisation principles.[43]

The following section of this chapter analyses the most critical aspects derived from the legal framework applicable to privatisations in Colombia and the lessons learned from our first-hand participation in these landmark cases.

39 In M&A transactions with government entities regulated under private law, different rules on applicable law and dispute resolution may be agreed upon by the parties.

40 Article 90 of the Political Constitution of Colombia.

41 As regulated in Article 1603 of the Colombian Civil Code and in Article 871 of the Colombian Code of Commerce.

42 See the *Betania* case, settled through the Ruling of 19 November 2012 of the Third Section of the Contentious Administrative Law Matters Chamber (Sección Tercera de la Sala de lo Contencioso Administrativo) of the Colombian Council of State, Justice Jaime Orlando Santofimio Gamboa.

43 ibid.

Critical issues and relevant experiences

The Isagen case

Due diligence, valuation of assets and fiscal liability

After considerable legal and political turmoil, in January 2016 the Colombian Ministry of Finance successfully sold to a Brookfield investment vehicle its majority stake in energy generation company Isagen SA ESP (Isagen). This landmark case, which constitutes the largest privatisation successfully completed in Colombia until 2021, raised numerous issues regarding the legal framework applicable to this type of transaction and the degree of liability assumed by the public entity and officials undertaking the operation. The *Isagen* case revealed the vulnerability of the privatisations regime to legal and political attacks, and how these attacks can seriously delay the bidding process and jeopardise the overall certainty of closing the deal. Among the several legal issues raised by the *Isagen* case, the due diligence process constitutes one of the main aspects to be considered for future transactions.

Pursuant to Law 226, sales programmes for privatisations must be based on technical studies that must include a valuation of the target company.[44] Considering the aforementioned protection of public treasury principle, this valuation becomes a critical aspect of any privatisation. After the Isagen transaction was finally completed, considerable issues were raised by control entities and opposing parties regarding the final value of the transaction. The Ministry of Finance faced numerous allegations from the Comptroller General's Office questioning the final price under which the transaction was completed, alleging a potential fiscal liability derived from a possible detriment to the public treasury. These allegations constituted a direct challenge to the valuation exercise under which the sales programme of the Isagen process was structured, and, by extension, to the due diligence performed by the legal advisers to the selling party. These allegations were strongly dismissed by the Council of State, which concluded that the protection of public policy principle envisaged in Law 226 was properly observed when the minimum price per share set forth in the sales programme was determined based on an valuation of the target entity performed by an independent financial expert, relying on customary company valuation methods for M&A transactions.[45] However, the aftermath of the *Isagen* case raised significant

44 Articles 6 and 7 of Law 226.

45 See Ruling of 10 September 2015 of the Fourth Section of the Contentious Administrative Law Matters Chamber of the Colombian Council of State, Justice Hugo Fernando Bastidas Bárcenas.

concerns for public entities and officials engaging in privatisation operations, who reasonably feared possible fiscal liability and disciplinary findings by control entities in future deals.

When participating in due diligence processes for privatisation operations or assisting in the valuation process of the company, this particular situation can trigger a misguided tendency by public officials to attempt to minimise fiscal liability findings by maximising the sale value of the target asset, regardless of market conditions or financial capacity of the bidders.

The 'sole bidder' discussion and interaction with public procurement rules

Grasping correctly how the special privatisation rules contained in Law 226 interact with general public procurement laws and principles is one of the major challenges when engaging in privatisations in Colombia. Even though there is an express provision in Law 226 stating that general public procurement rules are not applicable to privatisations,[46] the practical objective of this exclusion is to carve out the selection of advisers to the selling entity and the final purchaser in the process from public procurement rules and selection mechanisms, not to exclude all rules from public procurement or public administration laws. General principles of public administration, such as transparency, efficiency, due process and economy,[47] must be fully observed by all public entities and officials undertaking privatisations.[48]

One of the major legal discussions stemming from the *Isagen* case was the legality of adjudication mechanisms allowing for a privatisation to be completed with a single bidder. In the *Isagen* privatisation, the regulation enacted by the Ministry of Finance for the second stage of the transaction envisioned a special auction at the Colombian Stock Exchange[49] as the adjudication mechanism of the shares, which did not require multiple bidders for the auction to take place. The auction took place with the sole participation of Brookfield, and numerous questions were raised regarding the legality of the mechanism, mainly from a

46 Article 2 of Law 226.

47 Article 209 of the Colombian Constitution and Article 3 of Law 1437 of 2011, available at www.secretariasenado.gov.co/senado/basedoc/constitucion_politica_1991_pr006.html#209 and http://www.secretariasenado.gov.co/senado/basedoc/ley_1437_2011.html#3, respectively (accessed on 17 May 2021).

48 See Concept 2314 of 15 December 2016 of the Consultation and Civil Service Section of the Colombian Council of State.

49 Bolsa de Valores de Colombia.

misconceived applicability of regular public procurement rules and selection mechanisms to privatisations. Fortunately, the Council of State affirmatively settled the matter, stating that the democratisation principle of Law 226 is correctly observed when the selling entity adopts all reasonable measures to allow interested investors to participate in the privatisation, without this entailing that multiple offers are required for the sale to be valid under applicable privatisation laws.[50]

The misconceived applicability of public procurement rules and selection mechanisms to privatisations is a sensible matter, as it can encourage the implementation of complex adjudication mechanisms that have counterproductive effects for the transaction from a dealmaking perspective.

Regional politics – the EPM and ETB experiences

From a procedural standpoint, Law 226 requires the selling party in a privatisation to obtain an authorisation from certain political bodies prior to the formal initiation of the sales process. If the seller is the Colombian nation (i.e., the Ministry of Finance directly or a state-owned company controlled by the central government), the sales programme must be approved by the Council of Ministers, which also determines the minimum price per share for the transaction.[51] However, when the selling party is a territorial entity (such as the Capital District of Bogotá) or a state-owned company controlled by a territorial entity, the sales programme must be approved by a political organ within the territorial jurisdiction of the selling entity. These organs are the council (*concejo*), for cities and districts, and the departmental assembly (*Asamblea Departamental*) for departments.[52] Unfortunately, these entities work significantly differently to the Council of Ministers, and from a functional perspective they operate more as legislative organs than as administrative or executive organs (although they are part of the executive branch of power and not the legislative branch).[53] This particular rule is one of the most troublesome procedural requirements set forth in Law 226 and has become one of the major deal-breakers for privatisations at the regional level. The main complications derived from this requirement are (1) the political cost and complexities of the authorisation process as such; and (2) the legal exposure to procedural defects that may jeopardise the overall validity of the transaction.

50 See Ruling of 9 March 2017 of the Fourth Section of the Contentious Administrative Law Matters Chamber of the Colombian Council of State, Justice Jorge Octavio Ramírez.

51 Article 8 of Law 226.

52 id., Article 17.

53 Articles 312 and 313 of the Colombian Constitution.

A case that perfectly depicts the complications derived from this requirement is the failed Empresa de Telecomunicaciones de Bogotá SA ESP (ETB) privatisation, a long-lasting project pursued recurrently by conservative administrations in Bogotá and strongly opposed by left-wing counterparts. On 27 April 2017, the District of Bogotá issued Decree 207 of 2017, which contained the sales programme for the privatisation of the 86.35 per cent equity stake owned by the District of Bogotá and other public entities in telecommunications company ETB. Prior to the enactment of this Decree, the District of Bogotá had obtained approval from the Council of Bogotá.[54] The article authorising the District of Bogotá to undertake the privatisation was embedded in the Development Plan of Bogotá for the 2016–2020 term, an extensive document with more than 160 articles relating to numerous and diverse topics. A nullity action was filed against this article, alleging the inclusion of this authorisation in the Development Plan:

- had been made abruptly and with an insufficient degree of debate;
- violated the unity of matter principle;[55] and
- was flawed from a procedural standpoint.

A couple of days after the initiation of the Solidarity Sector stage, in May 2017 the Fourth Administrative Court of the Circuit of Bogotá issued an injunction ordering the immediate suspension of the process while the merits of the nullity claim were assessed, and in July 2017 declared the nullity of the provision. In December 2018, the Administrative Tribunal of Cundinamarca confirmed this ruling. In February 2019, the Secretary of Finance of Bogotá formally declared its decision to desist from the sales process of ETB.[56] From a strategic perspective, the failed ETB process provides valuable lessons for future privatisations regarding the process of obtaining authorisations from regional political bodies. As politically sensible transactions, privatisations require stand-alone debates and, if authorisation is granted, it should be provided for a reasonable term and formalised through a single-purpose legal document.

54 Authorisation granted through Article 140 of District Accord No. 645 of 2016, approved on 9 June 2016, available at: https://www.alcaldiabogota.gov.co/sisjur/normas/Norma1.jsp?i=66271 (accessed on 17 May 2021).

55 Article 158 of the Colombian Constitution mandates that every draft bill of law or regulation must refer to the same subject matter and that any provisions or modifications therein that are not related to such subject matter will be inadmissible. See Ruling C-507 of 2020 of the Colombian Constitutional Court, Justice Jorge Enrique Ibáñez Najar, available at www.corteconstitucional.gov.co/relatoria/2020/C-507-20.htm (accessed on 19 May 2021).

56 See https://www.larepublica.co/economia/alcaldia-de-bogota-desiste-de-la-venta-de-las-acciones-de-la-etb-2827419 (accessed on 18 May 2021).

Empresas Públicas de Medellín ESP (EPM), a public utilities company owned by the city of Medellín, has faced similar difficulties regarding this authorisation. In 2019, EPM attempted to sell its 10.17 per cent equity stake in major energy transmission company Interconexión Eléctrica ISA SA ESP (ISA). The Council of Medellín granted its authorisation in October 2018, giving EPM until 31 December 2019 to complete the operation.[57] The first stage directed towards the Solidarity Sector was finalised in June 2019 and the second stage was officially launched a couple of weeks later. Unfortunately, the remaining five months were insufficient for EPM to complete the deal, and reopening the debate for a new authorisation with the Council of Medellín was not a feasible alternative, as there was a profound struggle taking place between the mayor and council members regarding a major accident at the Hidroituango hydroelectric power plant being developed by EPM, an immense energy generation project valued at over US$4 billion. With this political context in place, EPM had to desist from its intention to sell its equity stake in ISA. More recently, the potential sale of the equity interest held by EPM in telecommunications company UNE EPM Telecomunicaciones SA ESP was also denied by the Council of Medellín.[58]

Limits to the Solidarity Sector – the Invercolsa case

No case better illustrates the challenges that can derive from the mandatory two-month stage destined to the Solidarity Sector than the Invercolsa deal.

In December 1996, the Colombian government issued a decree containing the sales programme for the privatisation of a 52.54 per cent equity stake owned by state-owned oil company Ecopetrol SA in Inversiones de Gases de Colombia SA (Invercolsa), a holding company with a portfolio of investments in the natural gas industry.[59] The offer directed at the Solidarity Sector was launched the following year, and on 30 April 1997 Fernando Londoño Hoyos acquired 145 million shares, representing an estimated 8.53 per cent equity stake in Invercolsa. To participate in the offer directed exclusively at the Solidarity Sector, Mr Londoño submitted

57 See Accord (Acuerdo) No. 090 of 2018 issued by the Council of Medellín, available at https://www.medellin.gov.co/normograma/docs/astrea/docs/A_CONMED_0090_2018.htm (accessed on 18 May 2021).

58 See https://www.semana.com/economia/capsulas/articulo/concejo-de-medellin-no-aprobo-venta-de-acciones-de-epm-en-une-e-invertelco/202221/ (accessed on 2 September 2022).

59 See Decree (Decreto) No. 2324 of 1996 issued by the Presidency, the Ministry of Finance and the Ministry of Mines and Energy, available at http://www.suin-juriscol.gov.co/viewDocument.asp?ruta=Decretos/1436599 (accessed on 18 May 2021).

a certificate asserting that he was a former employee of the company. Ecopetrol strongly opposed, alleging that Mr Londoño had never been a formal employee of Invercolsa but rather a legal adviser who, in that capacity, acted temporarily as president and legal representative of the company. Ecopetrol requested an intervention from the Superintendence of Companies, which deferred the dispute to the courts. The Supreme Court of Justice finally settled this matter in 2019, ruling in favour of Ecopetrol and concluding that Mr Londoño effectively had never been an employee of Invercolsa, which precluded him from participating in the Solidarity Sector offer and thus rendered his acquisition of 145 million Invercolsa shares null and void under Law 226.[60] However, during the 22 years in which the dispute was litigated before the competent courts, Ecopetrol was unable to continue with the privatisation process, primarily because of the inefficiencies derived from not being able to offer a controlling stake in Invercolsa.

This landmark case put the spotlight on the challenges derived from the Solidarity Sector phase, especially in cases of implementations contrary to the spirit of Law 226. As a consequence, in most privatisations following the Invercolsa deal in which controlling stakes were intended to be sold, selling parties started to implement a series of limitations to the participation of each individual member of the Solidarity Sector, based on the individual financial capacity of each member. Customary limitations contained in sales programmes for privatisations include the following.[61]

- For individuals: overall value of the shares to be purchased capped at the value of their liquid net worth for the prior year, or at five times their annual income or remuneration (the latter for directive employees) for the prior year.
- For legal entities: overall value of the shares to be purchased capped at the value of their adjusted liquid net worth for the prior year, or at five times their annual income for the prior year.

60 See Ruling 11001-31-03-028-1997-09465-01 of 30 October 2019 of the Colombian Supreme Court of Justice, Justice Aroldo Wilson Quiroz.

61 See the sales programme for the privatisations of Isagen, ETB, Grupo de Energía de Bogotá SA ESP and Colombia Telecomunicaciones SA ESP.

Additionally, sales programmes also include a maximum number of shares that can be purchased by each member of the Solidarity Sector and require (1) not negotiating or performing any act that entails a change in the ultimate beneficiary of the acquired shares during a given period of time; and (2) declaring under oath that each member of the Solidarity Sector is acting on its own behalf and for its own benefit. The legality of these limitations has been extensively recognised in Colombian case law,[62] as they are deemed valid mechanisms to:

- prevent the concentration of the equity participation being offered to certain persons or groups of interest;
- accurately reflect the acquisition capacity of each Solidarity Sector member; and
- foster an effective democratisation of state-owned property, as intended by Law 226.

Privatisation rules and securities regulations – the GEB experience

The interaction between Colombian securities regulations and Law 226 is also one of the major topics that must be properly understood when structuring privatisations. Two issues must be particularly emphasised: interaction of tender offer rules with Law 226 and disclosure of information.

Like most Latin American countries, Colombia adopted a mandatory tender offer rule for the acquisition of voting shares in the secondary market for listed companies.[63] The mandatory tender offer rule forces an investor to launch a shares purchase offer for the benefit of all shareholders of the target company upon the occurrence of certain triggering events.[64] However, Colombian

62 See Ruling C-037 of 1994 of the Colombian Constitutional Court, Justice Antonio Barrera Carbonell, available at www.corteconstitucional.gov.co/relatoria/1994/C-037-94.htm (accessed on 19 May 2021). See also the following rulings of the Colombian Council of State: 2919 of 10 February 1995, Justice Libardo Rodríguez; 2958 of 16 August 1995, Justice Yesid Rojas Serrano; 3566 of 5 December 2002, Justice Olga Inés Navarrete Barrero; 15739 of 4 September 2008, Justice María Inés Ortiz Barbosa; and 15685 of 13 November 2008, Justice Ligia López Díaz.

63 Mandatory tender offers (Ofertas Públicas de Adquisición or OPA) are regulated by Decree 2555 of 2010 and by the General Rules of the Colombian Stock Exchange.

64 As per Article 6.15.2.1.1 of Decree 2555, any person or group of persons constituting the same beneficial owner who wishes to purchase 25 per cent or more of the outstanding voting shares of a listed company must launch a mandatory tender offer to purchase those shares. Likewise, any person or group of persons who, being the same beneficial owner of 25 per cent or more of the voting shares of a listed company, wishes to acquire more than 5 per cent of the outstanding shares of the company must also launch a mandatory tender offer to purchase those shares.

securities regulations provide a specific carve-out for privatisation processes.[65] As a general rule, if a public entity is selling its equity stake in a company listed in the Colombian Stock Exchange to a private party, and the transaction qualifies as a privatisation under Law 226, tender offer rules will not be applicable to the operation. However, the fact that privatisations are exempt from tender offer rules in seller-driven operations does not mean that public entities are not allowed to sell their equity interests in listed companies in buyer-driven tender offers in place in the market. Such was the case with the sale of the Isagen shares owned by Grupo de Energía de Bogotá SA ESP (GEB).[66] Pursuant to the sales programme of the *Isagen* privatisation described above, the buyer had to launch two tender offers for the remaining shareholding of the company within six months of the closing. As a result, between March and September 2016, two tender offers were launched for the remaining listed Isagen shares, including a 13.1 per cent equity stake owned by EPM and a 2.52 per cent stake owned by GEB. Both entities structured their sales programmes to allow the acceptance of tender offers in the market as a valid sales mechanism after the Solidarity Sector phase. Both companies successfully sold their Isagen shares through a tender offer and still remained within the framework of Law 226.[67]

Disclosure of information is also a sensitive issue, specifically when the target of the privatisation is a listed company. In these cases, milestones of the privatisation process that qualify as relevant information[68] under Colombian securities laws will need to be timeously informed to the Superintendence of Finance and revealed to the market. Occasionally, this obligation can entail counterproductive effects for the transaction, but inobservance can expose the company to the imposition of fines that could affect the dialogue between the listed company's management and the selling party throughout the process, which is crucial for successful completion of the deal.

65 Paragraph 2 of Article 6.15.2.1.2 of Decree 2555 provides a specific exception for privatisations from tender offer rules; Article 6.15.1.1.2 of Decree 2555 grants a general exception from the transactional systems of the Colombian Stock Exchange for sales of shares made by the Colombian Nation.

66 Operating as Empresa de Energía de Bogotá SA ESP when the Isagen deal was completed.

67 See Isagen's shareholding composition after the Brookfield tender offers of 2016 at www.superfinanciera.gov.co/jsp/loader.jsf?lServicio=Publicaciones&lTipo=publicaciones&lFuncion=loadContenidoPublicacion&id=61446 (accessed on 17 May 2021).

68 See Article 5.2.4.1.5 of Decree 2555 for situations that qualify as relevant information that must be disclosed to the market.

Covid-19 economic aftermath and upcoming challenges

The covid-19 pandemic has entailed devastating economic effects, particularly in emerging markets.[69] Many countries have entered into recessive economic cycles, experiencing situations such as substantial increases in unemployment rates, currency devaluation and skyrocketing fiscal deficits.[70] As at 30 April 2021, the fiscal deficit of Colombia had increased to nearly 8 per cent of GDP,[71] although it is expected to fall to 5.6 per cent of GDP in 2022.[72] In other Latin American jurisdictions, the fiscal situation is even more critical.[73] In times of recession or considerable economic turmoil, the sale of public assets can evolve from being a simple potential source of liquidity into a mandatory fiscal strategy for public entities.[74] In this context, it is reasonable that national governments are exploring all potential sources of income to face the economic crisis, including the sale of public assets and state-owned companies, either to private parties or to other state entities or state-owned companies. Thus, it can be reasonably expected that privatisations and M&A transactions involving public entities will rise significantly in the coming years.

As explored in detail throughout this chapter, privatisations constitute one of the most complex and challenging fields of work in M&A practice. Legal frameworks in Latin America tend to serve more as roadblocks rather than as deal facilitators, and political opposition from anti-neoliberal trends will be a constant

69 Frankel, J, *The Impact of the Pandemic on Developing Countries* (Harvard Kennedy School, 2020).

70 Jackson, J, et al., *Global Economic Effects of COVID-19* (Congressional Research Service, 2021).

71 According to Colombia's Financial Plan, the fiscal deficit for 2020 was calculated at 7.8 per cent of GDP, while it is calculated that the expected fiscal deficit for 2021 will be 8.6 per cent of GDP; available at https://www.irc.gov.co/webcenter/ShowProperty?nodeId=/ConexionContent/WCC_CLUSTER-156938 (accessed on 14 May 2021).

72 According to Colombia's Mid-Term Fiscal Framework presented by the Ministry of Finance in June 2022. See: https://www.minhacienda.gov.co/webcenter/portal/SaladePrensa/pages_DetalleNoticia?documentId=WCC_CLUSTER-196967 (accessed on 2 September 2022).

73 In Argentina, the fiscal deficit for 2020 was calculated at 10.4 per cent of GDP according to the IMF forecast (International Monetary Fund, 2021), and the Peruvian fiscal deficit was calculated at 11.1 per cent of GDP according to the Peruvian Statistical Institute (Instituto Nacional de Estadística e Informática, 2021).

74 Christodoulakis, G, 'Privatization of State Assets in the Presence of Crisis', in *Managing Risks in the European Periphery Debt Crisis: Lessons from the Trade-off between Economics, Politics and the Financial Markets* (Macmillan, 2014).

opposing force for this type of deal. Even though there have been certain efforts intended to improve and add flexibility to the Colombian privatisation regime,[75] a long road lies ahead in the task of modernising and optimising the regulatory environment applicable to privatisations and M&A operations with public entities. This landscape makes the role of legal advisers crucial to the successful completion of these transactions.

75 On 4 June 2020, the Ministry of Finance issued Decree 811 of 2020, which intended to establish a series of special rules relating to the investment and sale of state-owned equity interests within the state of emergency declared by the Colombian government due to covid-19. Specifically, Decree 811 established measures for (1) the investment and divestment of equity instruments acquired or received by the Colombian state within the context of the economic emergency; and (2) the sale of state-owned equity interests in companies listed in the Colombian Stock Exchange, the proceeds of which are destined to attend the effects of the economic emergency. However, Decree 811 of 2020 was declared unconstitutional by the Colombian Constitutional Court through Ruling C-416 of 2020, by Justice José Fernando Reyes Cuartas; available at https://www.corteconstitucional.gov.co/relatoria/2020/C-416-20.htm) (accessed 17 May 2021).

Part III

New Transaction Dynamics and Evolving Trends in Latin America

CHAPTER 7

Distressed Mergers and Acquisitions: Lessons from the Venezuela Experience

Fulvio Italiani and Giancarlo Carrazza[1]

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

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

In the first two editions of this guide, we reflected upon the lessons from our experience advising buyers and sellers in 2014–2020 in the distressed M&A scene in Venezuela and translated those lessons into the description of the principal features of those Venezuelan distressed M&A deals.

In 2020, the Venezuela M&A scene started to change into a more traditional (yet still distressed) one. Therefore, this chapter also describes the developments of recent M&A deals during 2020 and 2021, amid a less unstable environment.

1 Fulvio Italiani is a partner and Giancarlo Carrazza is an associate at D'Empaire. The information in this chapter was accurate as at October 2022.

We believe that comparing these developments with the features of distressed M&A deals in the 2014–2020 period could be useful in other jurisdictions as they face adverse macroeconomic and political conditions, while offering lessons on a path forward after enduring downturns.

Evolution of M&A in Venezuela

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

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

From 2006 to 2013, the government nationalised several industries as part of its policy of reducing the influence of multinational corporations. These nationalisations were fuelled by a surge in oil prices, and were carried out either

2 Notable privatisations included: CANTV, Venezuela's largest telecoms services provider in 1991 (the VenWorld Consortium, led by GTE Corporation (now Verizon), purchased 40 per cent of CANTV's capital for an amount of US$1.8 billion); Viasa, Venezuela's then flag carrier in 1991 (Iberia, together with Banco Provincial, purchased 60 per cent of Viasa's capital for an amount of US$145.5 million); and Sidor, Venezuela's largest steel producer in 1998 (the Amazonia Consortium, a group of Latin American steel producers led by Argentina's Siderar, purchased 70 per cent of Sidor's capital for US$1.2 billion). This decade also saw the opening of the oil industry to private investment – *apertura petrolera* – through the award of strategic associations, profit-sharing and operating agreements to international oil and gas companies.

3 Notable takeovers and takeover attempts included: La Electricidad de Caracas (EDC), Venezuela's largest utility company in 2000 (AES Corporation purchased 87 per cent of EDC's capital through a US$1.66 billion unsolicited dual tender offer for the shares and ADRs of the company in Venezuela and the United States); AES then tried to acquire 43.2 per cent of CANTV's capital through a US$1.37 billion unsolicited dual tender offer in 2001, but AES withdrew the offer as a result of the September 11 attacks and CANTV's rejection of the offer (Marc Lifsher and Robin Sidel, 'AES Withdraws Its Bid For Venezuela's CANTV', *Wall Street Journal*, 8 November 2001, www.wsj.com/articles/SB1005145018782374000); Digitel, a major mobile telecoms operator in 2000 (Telecom Italia purchased 55.6 per cent of Digitel's capital in 2000, and then sold 100 per cent of its interest to Grupo Televenco in 2006 for US$425 million); and Mavesa, one of Venezuela's largest food manufacturers in 2001 (Grupo Polar, Venezuela's largest industrial conglomerate, purchased 100 per cent of Mavesa's capital pursuant to a US$480 million dual tender offer for the shares and ADRs of the company in Venezuela and the United States).

through outright nationalisations (in many cases without compensation to the owners of the nationalised businesses or assets)[4] or negotiated M&A transactions (i.e., mergers and nationalisations (M&Ns)).[5]

The year 2014 was marked by political upheaval, and Venezuela remained politically and economically unstable for many years as a result of the collapse of oil prices and Venezuela's oil production,[6] the political situation, deadlock and US sanctions (as we explain in the paragraph below, that instability started to change, to a certain degree, in 2020). This situation left the country with a strikingly

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

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

6 Kejal Vyas and Ginette González, 'Oil Industry Is Fading Away in Land of the World's Richest Reserves', *Wall Street Journal*, 4 September 2020, www.wsj.com/articles/oil-industry-is-fading-away-in-land-of-the-worlds-richest-reserves-11599238961.

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

Starting in 2020, the government began to ease several controls affecting the economy.[9] The government repealed foreign exchange regulations criminalising foreign currency exchange transactions and the sale of goods and services in foreign currency. The Venezuelan economy has become informally dollarised; an increasing number of transactions are settled in US dollars, but banks remain shy from opening US-dollar-denominated accounts due to opaque regulations, and taxes and other duties are still payable in local currency exclusively. Price control regulations have not been enforced as much as in previous years, except for a few notable cases.[10] The government has also aggressively promoted imports by eliminating import tariff and duties.

These changes in the economic conditions gave way to improvements in the performance of certain industries (e.g., dollarisation for the consumer goods industry) and as such, nourished an increasing interest in the country by

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7 'Gross domestic product shrank from about $196 billion in 2013 to some $80 billion last year, smaller than that of Guatemala or Ethiopia'. See Santiago Pérez, 'Venezuela's Economic Collapse Explained in Nine Charts', *Wall Street Journal*, 25 March 2019, www.wsj.com/articles/venezuelas-economic-collapse-explained-in-nine-charts-11553511601?mod=article_inline.

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

9 Ryan Dube, Juan Forero and Kejal Vyas, 'Maduro Gives Economy a Freer Hand to Keep His Grip on Venezuela', *Wall Street Journal*, 30 January 2020, www.wsj.com/articles/maduro-gives-economy-a-freer-hand-to-keep-his-grip-on-venezuela-11580380203.

10 In April 2020, the government enforced price control regulations against Polar, Plumrose and Coposa, three large food manufacturers.

various players. This increased interest in the country altered some of the fundamentals of a Venezuelan M&A deal, and thus many of the features we saw in M&A deals in the 2014–2020 period (described below) became less frequent or changed altogether.

Triggers of distressed M&As in Venezuela in the 2014–2020 period

On the one hand, exiting Venezuela became necessary for many multinationals because of the challenges to operate a business in Venezuela (the 'operational trigger'). On the other hand, liquidating or winding down the business, or shutting down operations in Venezuela altogether, is unfeasible or raises significant risks and, therefore, the sale of the operations to a third party became the most viable alternative (the 'legal trigger'). These two triggers account for the increase in distressed M&A activity in Venezuela in recent years.

Operational trigger

Venezuelan businesses became increasingly difficult to operate for a number of reasons.

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

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

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

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

Labour freezes have remained in force for many years. Under Venezuelan law, employees cannot be unilaterally terminated by the employer without cause. Termination of employees for cause (such as theft, absenteeism) has become practically impossible because terminations must be approved by government officials (*inspectores del trabajo*), who rarely do so. Thus, terminations have to be achieved by negotiating enhanced termination packages with the employees to incentivise their resignation.[11] Union leaders, health and safety delegates and employees on maternity or sick leave are under special protection and may require tailor-made termination packages in exchange for their resignations.[12]

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

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

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11 Fulvio Italiani and Carlos Omaña, 'Navigating a Corporate Crisis: Managing the Risks of Downsizing in Venezuela', in Sergio J Galvis, Robert J Giuffra Jr and Werner F Ahlers (eds), *The Guide to Corporate Crisis Management* (4th edition, Latin Lawyer, 2021), p. 75.

12 ibid.

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

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

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

Legal trigger

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

Under Venezuelan law, it is not possible to unilaterally liquidate a business as a way to exit the country.[13] As mentioned above, employees cannot be unilaterally terminated by the employer without cause, and voluntary liquidation is not a cause for the termination of employees under Venezuelan law.

In light of this, some multinationals exited the country by permanently shutting down their operations in Venezuela while maintaining the legal vehicle, paying all labour obligations with their employees and debt with their suppliers.[14] However, in many cases, the shutdown triggered a strong reaction from the government,

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

14 See Corina Pons, 'Venezuela Takes Over Plants Left by U.S Firm Clorox', Reuters, 27 September 2014, www.reuters.com/article/us-clorox-venezuela/venezuela-takesover-plants-left-by-u-s-firm-clorox-idUSKCN0HL2FW20140927; 'Is It the End? Venezuela Takes Over Kimberly Clark Operations', https://www.barrons.com/articles/is-it-the-end-venezuela-seizes-kimberly-clark-operations-1468342351; Mayela Armas and Juan Forero, 'Kellogg Pulls Out of Venezuela, Citing Its "Deterioration"', *Wall Street Journal*, 15 May 2018, www.wsj.com/articles/kellogg-pulls-out-of-venezuela-citing-its-deterioration-1526419980.

including the criminal prosecution of key employees based in the country arguing economic destabilisation, boycott, labour breaches or otherwise. In addition, the government has the legal power to 'temporarily intervene' companies to 'protect employment'.[15] After these interventions, the government has started operating the businesses and even kept manufacturing the same branded products without the consent of the owner of the brand.[16]

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

Principal features of distressed M&As in Venezuela in the 2014–2020 period

Out-of-court sale

One of the most salient features of distressed M&A activity in Venezuela is that it occurs outside of insolvency proceedings for two reasons. On the one hand, businesses have low amounts of debt mainly because local currency financing got diluted by hyperinflation, and the only significant foreign currency denominated debt is generally intercompany debt. On the other, the existing insolvency processes contemplated under Venezuelan law are old and ill-equipped to liquidate the insolvent company.[17] This causes the owner of the Venezuelan business to avoid the lengthy and uncertain insolvency proceedings and aim for an out-of-court sale of their businesses.

Type of buyer

The buyer of a distressed transaction in Venezuela during this period typically had a considerable tolerance for risk and bet on a political or economic change.

Not surprisingly, typical buyers in Venezuela during the 2014–2020 period included family offices of high net worth individuals from Venezuela, Latin America and Europe. The family offices' streamlined decision-making process,

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

16 Luis Cabrera, 'Kellogg's to Take Legal Action Against Venezuela for the Improper Use of the Brand after Expropriation', *Brands*, 7 October 2019, www.brandsprotectionnews.com/en/kelloggs-to-take-legal-action-against-venezuela-for-the-improper-use-of-the-brand-after-expropriation/.

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

secrecy and focus on investments with an indefinite time frame gave them a significant competitive edge. Other institutional investors and global strategic players were uncommon.

Financial debt

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

'As is' transfer

Transfers were typically made on an 'as is' basis, with very limited sellers' representations and warranties and indemnity obligations. Sellers' representations and warranties were generally limited to 'fundamental representations', that is, representations and warranties relating to organisation and standing, capitalisation, powers and authority, consents and approvals and title to the transferred interests or assets, and representations and warranties related to anti-money laundering (AML), anti-corruption and trade sanctions. Sellers typically required buyers to provide representations and warranties related to organisation and standing, powers and authority, consents and approvals, sources of funds, no financing condition, AML, anti-corruption and trade sanctions, as well as non-reliance provisions.

Asset purchase versus stock purchase

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

Purchase price and valuation methods

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

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

Investment bankers

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

Local management

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

Simultaneous signing and closing

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

Covenants

As signing and closing usually took place simultaneously, pre-closing covenants (such as conduct of business) were usually not included. In certain transactions, purchasers accepted post-closing covenants relating to continuation of the business and treatment of employees. However, in general, purchasers were reluctant to accept these covenants.

Repurchase options

In certain transactions, sellers negotiated an option to repurchase the Venezuelan business at a significant premium. This option may allow sellers to re-enter the Venezuelan marketplace, and some players may be interested in doing so, considering improving economic trends. Given the significant uncertainties on the political and economic prospects of the country, it was generally very difficult to agree on a valuation method to calculate the repurchase price.

Governing law and dispute resolution

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

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

Post-closing challenges

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

Developments in recent M&A deals in Venezuela since 2020

Type of buyer

US and Latin American private equity firms have started to become common players in the current Venezuelan M&A scene. This may be due to the fact that certain investment and financial fundamentals are observed again in some Venezuelan businesses, in part due to the dollarisation of the economy and the lifting of exchange and price controls. Also, the current environment offers significant opportunities in terms of rate of return, because the operations of many Venezuelan companies can be streamlined and optimised to generate value in the coming years, should the current trends continue. Other institutional investors and global strategic players are still uncommon, mainly because of the effect of the uncertainty on the lifting of the international and US sanctions in the near future.

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

As economic conditions continue to improve, the normalising of historical trade levels with strategic markets, such as Colombia, should be expected to prompt M&A activity as foreign companies seize the opportunity to re-establish operations in Venezuela and cater to a widely underserved market.

Representations and warranties

'As is' transfers have become much less common since 2020. Extensive disclosure schedules and thoroughly negotiated representation and warranties provisions are now common, as sellers now seldom ask for nominal prices (as described below).

18 ibid. Fulvio Italiani and Carlos Omaña, 'Navigating a Corporate Crisis', op. cit., p. 74.

Tax representations are particularly relevant, as the assessment of contingencies for tax liabilities becomes difficult due to the lack of certainty on the tax authority's interpretation of tax provisions in most cases.

Representations and warranties related to anti-money laundering (AML), anti-corruption and trade sanctions continue to be important.

Representations and warranties insurance is not currently feasible in Venezuela given local conditions, and political and economic risk, which insurers are still not prepared to cover.[19]

Purchase price

As mentioned above, prices are no longer nominal, due to the recent changes in economic conditions. Purchase price adjustments for working capital and net financial debt are no longer unusual, though still less common than in other jurisdictions due to complexities mainly derived from exchange rate volatility.

Bidding processes

Between 2014 and 2020, it was common for sellers to select a buyer and proceed with direct one-on-one and often exclusive negotiations for the sale of their Venezuelan operations as swiftly as possible. From 2020, bidding processes for private companies have been once again deployed in some cases, in light of the number of interested players.

Venture capital and start-ups

While considerably smaller than the start-up activity present in Latin America (especially in Mexico and Brazil), 2020 marked the appearance of some start-up companies in Venezuela as a consequence of the dollarisation of the economy. Some have scaled up considerably and are now operating in many cities in the country.[20,21]

The success of these start-ups and the possibilities for sustained growth over the years and related development of a venture capital/start-up legal industry will, of course, be contingent on the stability of economic and political conditions

19 See the 'Representations and Warranties Insurance in Latin American M&A: A long-coming alternative in the face of current challenges' chapter in this guide.

20 Notable cases include Delivery Hero's PedidosYa entering the country; delivery app Yummy; payment platform Ubii; ride-hailing app Ridery; and private collective transportation app La Wawa.

21 See the 'Key Terms and Trends in Venture Capital Investments' chapter in this guide.

in the near future. In any case, we believe that recent developments marked a watershed moment and a change of mindset on the viability of these types of businesses in Venezuela.[22]

Conclusion

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

22 Notably, a tech accelerator was recently inaugurated inside the premises of one of the most iconic buildings in Caracas: Nicolle Yapur, 'Former P&G Building in Venezuela Converted Into Tech Hub', Bloomberg, 14 June 2022, www.bloomberg.com/news/articles/2022-06-14/venezuelans-open-tech-hub-in-icon-of-country-s-industrial-past.

CHAPTER 8

The Latin American M&A Market from an ESG Perspective

Randy Bullard, Giselle C Sardiñas and Daniel Villa[1]

The incorporation of environmental, social and governance (ESG) practices in guiding corporate decision-making in Latin America is following a growing global trend of focus on sustainability, ESG and impact investing by shareholders, customers and employees. Attorneys practising in the region should be prepared to address ESG matters in transactional preparation, due diligence investigations, acquisition documentation and post-closing operations as ESG practices are adopted by financial institutions, strategic investors and regulatory authorities throughout Latin America. However, even ahead of regulation, in most cases, ESG is considered both a driver of value in M&A and a means of reducing risks associated with operations post-acquisition.

Defining ESG

ESG criteria are standards that seek to integrate ESG data related to company performance into the decision-making and risk management process for investors, financial institutions and regulators, among others. Environmental criteria are used to consider how a company performs to reduce its impact on the natural environment (e.g., climate, energy emissions, water). Social criteria examine how companies manage their relationships with all stakeholders (e.g., employees, suppliers, customers and the communities in which they operate) rather than just shareholders. Governance risks concern how a company is run and are often

1 Randy Bullard is a managing partner, Giselle C Sardiñas is an associate and Daniel Villa was a 2023 summer associate at Morrison & Foerster LLP.

tied to areas such as company leadership, anti-corruption, executive pay, auditing, internal controls, transparency in disclosure, corporate governance and shareholder rights.

Background on ESG

ESG investing can potentially increase value and mitigate governance and social risks, such as loss of assets due to lawsuits, social discord, political intervention, environmental harm or regulatory fines and penalties. The market seems to agree, as asset managers are expected to emphasise ESG-specific investments. Asset managers worldwide are expected to increase their ESG-related assets under management to US$33.9 trillion by 2026,[2] as compared to approximately US$18.4 trillion in ESG-related assets in 2021. This increase represents a potential 84 per cent increase in ESG-specific investments between 2021 and 2026.[3] Stated differently, ESG-specific assets are anticipated to comprise up to 21.5 per cent of total global assets under management within three to five years.[4] However, Latin America is expected to capture only a small portion of that ESG market share, with ESG-specific investments in the region expected to amount to approximately US$25 billion.[5]

Moreover, between 2019 and 2022, index fund investment with an ESG focus increased from 3 per cent to 5 per cent and is expected to increase further in 2023.[6] Green, social or sustainability-linked bond issuances are forecasted to range between US$900 billion and US$1 trillion in 2023.[7] But the ESG debt market could increase to approximately US$15 trillion by 2025.[8] Start-ups

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2 See Ryan Stanton, 'ESG-Focused Institutional Investment Seen Soaring 84% to US$33.9 trillion in 2026, Making Up 21.5% of Assets Under Management: PwC Report', PWC (10 October 2022), https://www.pwc.com/gx/en/news-room/press-releases/2022/awm-revolution-2022-report.html.

3 ibid.

4 ibid.

5 ibid.

6 See Shakked Noy, 'Investors' Willingness to Pay for ESG Funds', National Bureau of Economic Research (1 January 2023), https://www.nber.org/digest/20231/investors-willingness-pay-esg-funds.

7 Patrice Cochelin, Bryan Papoola and Dennis Sugrue, 'Global Sustainable Bonds 2023 Issuance To Exceed $900 Billion', S&P Global, 14 September 2023, www.spglobal.com/esg/insights/featured/special-editorial/global-sustainable-bonds-2023-issuance-to-exceed-900-billion.

8 See Veronika Henze and Samantha Boyd, 'ESG May Surpass $41 Trillion Assets in 2022, But Not Without Challenges, Finds Bloomberg Intelligence', Bloomberg (24 January 2022), https://www.bloomberg.com/company/press/esg-may-surpass-41-trillion-assets-in-2022-but-not-without-challenges-finds-bloomberg-intelligence/.

focused on clean and renewable energy sources raised US$12.3 billion in 2022, up from US$1.9 billion in 2019.[9] This growth is linked to an accelerating push from governments globally to encourage climate-friendly investments, many of which are held by ESG funds, by transitioning to low-carbon energy economies and updating their market rules and tax regimes.[10] In Latin America and the Caribbean, foreign direct investment increased by 55 per cent between 2021 and the end of 2022 (approximately US$225 billion in 2022[11]) – growth that has rebounded from a 45 per cent drop in 2020, mainly due to the global pandemic – in large part due to a paradigm shift by multinational companies operating in the region to push a sustainable development agenda.[12]

BlackRock, State Street, T Rowe Price, Vanguard and other large fund managers have stated that ESG-focused companies create long-term value for stockholders. Some credit rating agencies have begun assessing ESG risk with the same rigour as traditional metrics like credit and liquidity risk. Meanwhile, law firms worldwide have started tailoring their services to provide clients with a comprehensive examination of their targets from an ESG perspective.

Tracking and analysing ESG information remains a work in progress, as no uniform reporting standard has been universally adopted. To further complicate matters, ESG considerations differ depending on the sector and region in which a company operates. Although there is currently no one globally accepted ESG measurement standard, the leading ESG standard organisations are:

- the Global Reporting Initiative;
- the Sustainability Accounting Standards Board (SASB);
- the Carbon Disclosure Project;
- the Carbon Disclosure Standards Board (CDSB); and
- the International Integrated Reporting Council (IIRC).

9 See Tommy Reggiori Wilkes, 'Venture capital investment in clean energy startups soars', Reuters (19 May 2023), https://www.reuters.com/sustainability/venture-capital-investment-clean-energy-startups-soars-2023-05-18/.

10 UNCTAD, *World Investment Report 2022*, https://unctad.org/publication/world-investment-report-2022, and UNCTAD, 'Foreign Direct Investment to Latin America Rebounded by 56% In 2021', https://unctad.org/news/foreign-direct-Investment-latin-america-rebounded-56-2021#.

11 See Natalia Ramos and Sarah Morland, 'Latin America, Caribbean Saw Record 2022 Investment, UN Commission Says', Reuters (10 July 2023), https://www.reuters.com/markets/latin-america-caribbean-attract-record-foreign-direct-investment-2022-eclac-2023-07-10/.

12 ibid.

These leading organisations are aware of the need to set one standardised measuring system for ESG and, in 2020, they published a prototype climate-related financial disclosure standard and a joint statement of intention to work with each other and other key institutions, including the International Organization of Securities, the International Financial Reporting Standards, the European Commission and the World Economic Forum's International Business Council, to develop global standards.[13]

ESG framework providers attempt to provide guidance as to which factors and indicators should be prioritised in different sectors. The SASB, for example, has worked to implement a uniform ESG reporting standard to aid investors in identifying the minimum set of sustainability issues likely to be material for companies within a given industry. The SASB's 'Materiality Map' highlights the types of risks prevalent across a multitude of sectors. The risk types span five major categories:

- environment;
- social capital;
- human capital;
- business model and innovation; and
- leadership and governance.

For example, the map identifies the following high-risk areas for a company that operates in the metals and mining sector: greenhouse gas emissions, air quality, energy management, waste and water management, waste and hazardous materials management, ecological impacts, labour practices, employee health and safety, and business ethics. A team working on an M&A deal can use this tool to identify the baseline risks in the target company's sector. Nonetheless, although ESG framework and standard setting institutions provide guidance as to the factors to analyse in each industry, and the SASB tries to focus on those sustainability factors that are likely to have material financial impact, there is still difficulty quantifying the financial impact or materiality of ESG data as ESG frameworks relate mostly to non-financial disclosures.

13 Impact Management Project, World Economic Forum and Deloitte, 'Statement of Intent to Work Together Towards Comprehensive Corporate Reporting', September 2020, https://29kjwb3armds2g3gi4lq2sx1-wpengine.netdna-ssl.com/wp-content/uploads/Statement-of-Intent-to-Work-Together-Towards-Comprehensive-Corporate-Reporting.pdf.

ESG standards may be broken down further into three separate classes:

- compliance;
- ESG issues material to a company's operations; and
- additional ESG policies that surpass those that are required by law or by regulatory authorities.

Compliance is an area where legal departments are heavily involved, and covers risks such as human rights, trafficking, slavery, conflict minerals, anti-corruption compliance, privacy and cybersecurity. ESG standards that are 'material to operations' flag and track those ESG standards imposed by regulations (e.g., Securities and Exchange Commission guidelines and SASB compliance), which carry reporting requirements and potential penalties for non-compliance. Finally, certain companies incorporate ESG policies that surpass those that are required by law or by regulatory authorities, such as having a corporate social responsibility policy and other philanthropic initiatives (e.g., carbon reduction, responsible sourcing, responsible AI development and inclusive economic opportunity commitments) that the company may, but is not legally required to, have.

State of ESG in Latin America

Although Latin America lags behind other regions in adopting ESG practices, Latin American companies are increasingly working to improve ESG standards following criteria established by growing international investor focus on ESG, and credit rating agencies that focus on ESG when evaluating a company's creditworthiness.[14] The shift of Latin American companies towards a more ESG-driven approach is reflected in the IndexAmericas[15] created by the Inter-American Development Bank, which highlights the top 100 sustainable firms operating in Latin America and the Caribbean, measured against ESG criteria. The IndexAmericas, which initially comprised mostly multinationals operating in the region, has seen an increase in recent years in the number of Latin American companies on the index of more than 30 per cent.

In Latin America, the financial industry and government regulators are driving ESG efforts, as evidenced by economic trends. Latin American governments are increasingly using ESG as an instrument to address social and environmental

14 S&P Global Ratings, 'ESG in Credit Ratings', https://www.spglobal.com/ratings/en/products-benefits/products/esg-in-credit-ratings#overview.

15 Inter-American Development Bank, 'The Four Dimensions of Sustainability Captured by IndexAmericas: ESGD', https://indexamericas.iadb.org/en/Aboutus.

matters and the consequences of the covid-19 pandemic. Countries in the region are promoting ESG policies to drive investment and address social unrest prevalent in the region. There is enhanced clarity that Latin America would benefit from low carbon energy solutions to address the growing threat of climate disasters, as well as stricter criminal laws, enforcement mechanisms and tools to address social inequality (such as exploitation, gender violence and poverty), environmental degradation and political corruption in the region. Commitments from local officials and governments to implement ESG policies attract investors focused on ESG to the region. Notable advancements by Latin American regulators in the ESG arena include the following.

Mexico

Approximately 73 per cent of the Mexican sustainable development goals (SDG) issuance went to 'sustainable investors', which incorporate ESG criteria into their investment decision-making process. Mexico has earmarked the proceeds from the bond issuance to finance ESG-related projects across 1,345 cities grappling with low literacy and school attendance rates, poor health services, lack of toilets, sewage and potable drinking water in homes, and lack of access to electricity.[16]

Mexico's pension fund regulator (CONSAR) has published rules regarding investment strategies that include an obligation to analyse companies' social responsibility credentials, which became effective in January 2022. As a result of this rule, retirement funds will be required to incorporate sustainability criteria in their methodologies and prioritise ESG investments in their portfolios, as well as advocate within the public companies in which they are represented for compliance with sustainable principles. In addition, companies that list their securities with the National Securities Registry must disclose in their annual reports the existence of any environmental policies, any projects impacting the environment and natural resources and any impacts of climate on the business of the listed company. In addition, the internal regulations of the Mexican stock exchange (BMV) require publicly traded companies to adhere to the Code of Professional Ethics and certify this compliance in the annual report of the listed company.[17]

16 United Nations Development Programme, 'Historic $890 million Sustainable Development Goals Bond issued by Mexico', 14 September 2020, https://www.undp.org/press-releases/historic-890-million-sustainable-development-goals-bond-issued-mexico.

17 www.bmv.com.mx/docs-pub/GRUPOBMV/codeofethicsandconductbmvgroup.pdf.

Mexico was home to Latin America's second ESG index. Additionally, the BMV has created exchange traded funds that replicate the performance of their ESG indices and as many as 21 sustainable (green, social and sustainable) bonds.[18] Lastly, in connection with the Climate Bonds Initiative, the BMV founded the Green Finance Advisory Council with the aim of promoting sustainable finance and public policy changes driven by ESG.

Brazil

A resolution passed by the Brazilian National Monetary Council (CMN) in 2018 requires pension fund asset managers to consider ESG risks as part of their investment decision-making process.[19] This development is a significant advancement from prior resolutions, as it increases the obligation from mere disclosure of ESG considerations to a mandate to integrate ESG issues whenever possible. On 30 April 2021, the Central Bank of Brazil (BCB) implemented regulatory initiatives to increase banks' ESG disclosures.[20] In 2021, the S&P Dow Jones Indices and the Brazilian stock exchange (B3) developed the S&P/B3 Brazil ESG Index to highlight strong ESG companies traded on the Brazilian stock exchange.[21]

On 23 December 2021, the Brazilian Securities and Exchange Commission (CVM) issued CVM Resolution 59, which provides changes to the reference form, including new disclosure obligations by publicly held companies in categories 'A' and 'B', especially regarding information relating to ESG matters. CVM Resolution 59 became effective on 2 January 2023, and applies to information concerning 2022. In early 2023, the CVM announced a package of technical

18 Nasdaq, 'Leading in an Era of Impact: Inside Bolsa Mexicana de Valores' Decade-long Journey to Build Sustainable Finance in Mexico', 30 July 2021, https://www.nasdaq.com/articles/leading-in-an-era-of-impact%3A-inside-bolsa-mexicana-de-valores-decade-long-journey-to-build.

19 United Nations Environment Program Finance Initiative, 'Brazilian Monetary Authority Approves New ESG Requirements in the Investment Rules of Occupational Pension Funds', 10 July 2018, https://www.unepfi.org/news/industries/investment/brazilian-monetary-authority-approves-new-esg-requirements/.

20 Central Bank of Brazil (BCB), 'BCB Public Consultation No. 86/2021 – Regulation on the disclosure of social, environmental, and climate-related risks by financial institutions', 30 April 2021.

21 S&P Dow Jones Indices, 'S&P/B3 Brazil ESG Index', https://www.spglobal.com/spdji/en/indices/esg/sp-b3-brazil-esg-index/#overview.

cooperation agreements and regulatory innovations, which have a direct impact on agribusiness, strengthening the mechanisms for entrepreneurs in that sector to access capital markets and leverage the green finance market in Brazil.[22]

In 2022, the CMN and the BCB issued a number of resolutions aiming to improve the rules for the management of social, environmental and climate risk applicable to financial institutions and other institutions authorised to operate by the BCB. These resolutions also include the requirements for institutions in the establishment of their social, environmental and climate responsibility policies and in the implementation of actions designed to ensure effectiveness.[23]

Upon the approval of Decree No. 11,129/2022, the methods used by public authorities to evaluate companies' compliance programmes has changed. Bill No. 572/2022, which is still under discussion in the Brazilian Congress, aims to establish compliance parameters for companies to respect and enforce human rights within their organisations. Both regulations bring Brazilian legislation closer to international ESG practices.

The Brazilian government has published several federal decrees to reorganise and establish a new governance and improved legal framework for climate change and the reduction of greenhouse gases.[24] Pursuant to one of these decrees, technical committees were created to provide public policies and private initiatives to advance the SDGs and low-carbon transition plan.[25] Another decree established the Sovereign Sustainable Finance Committee as an inter-ministerial body responsible for creating governance rules for the issuance of sustainable government bonds backed by projects related to environmental and social issues outlined in the government budget.[26]

In January 2023, the CVM announced its Sustainable Finance Policy, whose goal is to prioritise the ESG agenda and sustainable finance by outlining general and strategic guidelines.[27] In May 2023, several associations and companies signed

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22 https://valor.globo.com/legislacao/noticia/2023/04/25/pacote-cvm-e-o-mercado-de-financas-verdes.ghtml.

23 National Monetary Council (CMN) Resolution No. 4,943/2021, CMN Resolution No. 4,945/2021 and BCB Resolution No. 151/2021, which became effective on 1 July 2022, and CMN Resolution No. 4,944/2021 and BCB Resolution No. 139/2021, which became effective on 1 December 2022.

24 Federal Decree No. 11,555/2023, Federal Decree No. 11,546/2023, Federal Decree No. 11,548/2023 and Federal Decree No. 11,549/2023.

25 Federal Decree No. 11,547/2023.

26 Decree No. 11,532 of 16 May 2023.

27 Ordinance CVM/PTE No. 10/2023.

a cooperation agreement entitled the 'Brazilian Pact for Renewable Hydrogen' to accelerate the development of green hydrogen in the Brazilian energy matrix by pursuing the following five goals:

- defining legal regulation;
- promoting socio-economic development through the renewable hydrogen economy;
- communicating new opportunities arising from green hydrogen;
- boosting the competitiveness of production and use of alternative energy; and
- developing a green hydrogen market.

In April 2023, the Ministry of the General Comptroller's Office launched the integrity programme of the Human Rights Ministry, aiming at increasing transparency and targeting vulnerabilities that may threaten the Human Rights Ministry's reputation, public interest and social values.[28]

Chile

In November 2021, the Chilean Commission for the Financial Market (CMF) published General Rule No. 461 (NCG), which modifies the structure and content of ESG matters to be included in annual reports for entities issuing securities registered with the CMF Securities Registry. Under the new regulation, the NCG eliminates the former social responsibility and sustainable development section from the annual reports, replacing it with the obligation to report on ESG factors in all sections, increasing the minimum informational disclosure requirements for issuers. Every registered entity should describe how it integrates a sustainability and environmental approach in its business and detail its strategy to minimise the negative environmental aspects of the core business.

Registered entities should also provide information on ESG policies' risk management undertaken by their boards of directors in monitoring and adhering to ESG models and programmes. Additionally, the entities should disclose the frequency with which environmental and social matters are reported, especially with respect to climate change, and whether these matters are included when discussing and adopting strategic decisions, business plans or budgets.

Finally, the entities should disclose their ESG models and programmes containing information on the definition of their ESG obligations, compliance modality, implementation deadlines, reporting unit, environmental risk matrix and any related relevant background. If ESG models or programmes are

28 Decree No. 11,529 of 16 May 2023.

not available for a registered entity, this fact must be clearly disclosed in annual reports indicating the reasons they are not available. In addition, the entity should disclose to the public the number of enforced sanctions registered in the Public Registry of Sanctions of the Environment Commission of Chile or its equivalent in foreign jurisdictions, along with:

- the total amount of fines;
- the number of approved compliance programmes; and
- details of:
  - compliance programmes successfully executed;
  - environmental damage repair plans presented; and
  - repair plans for environmental damage executed satisfactorily.

Registered issuers could voluntarily comply with the regulations for the 2022 tax year (for the report to be delivered in 2023); however, the regulations became mandatory on 31 December 2022, for entities that exceed the equivalent of approximately US$800 million in total consolidated assets, and will become mandatory on 31 December 2023, for stock exchange-registered corporations that exceed the equivalent of approximately US$45 million in total consolidated assets.

In March 2022, Chile became the first country in Latin America to issue a sovereign sustainability-linked bond. This US$2 billion bond adheres to the Paris Climate Accords, and includes commitments to reduce carbon dioxide emission and increase renewable energy production to 60 per cent of electricity needs by 2032. With this new issuance, Chile has placed over US$33 billion in socially and environmentally responsible bonds in the past three years, making it a pioneering country in terms of green, social and sustainability-linked bonds.[29]

On 13 June 2022, Chile published its Climate Change Framework Law, which includes a binding target of net zero emissions by 2050. It creates cross-agency and departmental coordination and cooperation beyond the Ministry of

29 Ryan Jeffrey Sy, 'World's 1st sovereign sustainability linked bond issued by Chile', S&P Global Market Intelligence, 4 March 2022, https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/world-s-1st-sovereign-sustainability-linked-bond-issued-by-chile-69226229.

the Environment to make carbon emissions compliance, targeting and goals a matter of national importance, and not exclusively within the purview of solely environmental agencies.[30]

In June 2023, Chile's Ministry of Finance published its updated Sustainability-Linked Bond Framework, which sets out the country's strategy for achieving social sustainability, which is the third of three key pillars[31] that have been developed to help realise Chile's inclusive and sustainable development strategy. The strategy involves a new social key performance indicator (KPI), which 'focuses specifically on increasing the percentage of women board members' in Chilean companies. The issuance of sustainability-linked bonds is tied to this KPI, which will enable Chile to reinforce the importance of gender equality at the highest levels of management in both the public and private sectors. This will impact the workforce and governance structures of Chilean companies, while contributing towards the country's inclusivity and sustainability targets. Achieving the targets set out by the government in this Framework will require material efforts by all companies reporting to the CMF.[32]

Colombia

The Colombian National Council on Economic and Social Policy (CONPES) enacted laws and policies such as the Green Growth Policy (CONPES 3934) and the Strategy for the Implementation of Sustainable Development Objectives in Colombia (CONPES 3918), which exemplify a commitment to exploring new sources of sustainable economic growth.[33] These policies incorporate ESG into Colombia's strategic initiatives to maintain sustained development. The CONPES policies prioritise the diversification of Colombia's economy based on

30 Robert Currie Ríos and Tiffany Challe-Campiz, 'Chile Adopts New Climate Change Framework Law: A Paradigm Shift', 22 June 2022, *Climate Law*, Sabin Center for Climate Change Law, Columbia Law School, https://blogs.law.columbia.edu/climatechange/2022/06/22/chile-adopts-new-climate-change-framework-law-a-paradigm-shift.

31 The three key pillars are economic, environmental and social sustainability.

32 'Chile's Sustainability-Linked Bond Framework', Public Debt Office of the Ministry of Finance of Chile, June 2023.

33 Colombian National Council on Economic and Social Policy (CONPES), 'Estrategia para la Implementación de los Objetivos de Desarrollo Sostenible (ODS) en Colombia', 15 March 2018, https://colaboracion.dnp.gov.co/CDT/Conpes/Econ%C3%B3micos/3918.pdf.

commitments to sustainable use of the country's natural resources, strengthening the nation's human capital, and transparent incorporation of ESG metrics in evaluating future projects and investments.[34]

Colombia has also made concrete strides to solidify ESG initiatives in its financial infrastructure. In April 2021, Colombia's Financial Superintendence (SFC) adopted Circular 007, which requires that all Colombian institutional investors, as part of their mandated disclosures, discuss the ways in which ESG factors were evaluated when making investment decisions.[35] Colombia has enacted other laws, through different ministries and departments, which increase the disclosure requirements by domestic companies of their adoption and compliance with ESG policies. Lastly, the SFC has also promulgated laws such as Circular 028, which outlines the best practices for the issuance of green bonds by Colombian issuers.[36] The SFC has recently established goals for developing sustainable finance in Colombia, focusing on green taxonomy, financial innovation, data metrics and innovation, ESG and methods for measuring climate and nature risks.

ESG in Latin American M&A

Large international investors, companies and regulators stressing the importance of ESG are driving exponential growth in ESG diligence and disclosures during the life cycle of M&A transactions. As investors incorporate ESG performance metrics into a target's valuation and risk assessment, ESG key performance metrics are being gathered and measured during the diligence process and throughout the negotiation of acquisition contracts. ESG is being woven into M&A in the following areas: the diligence process, negotiation of contractual protections and post-closing integration of the target business into the overall ESG regime of the acquirer.

34 Brigard Urrutia, 'CONPES for sustainable economic recovery', 26 February 2021, https://bu.com.co/en/noticias/conpes-sustainable-economic-recovery.

35 Vlex, 'Circular externa 007 de Superintendencia Financiera, de 26 de Abril de 2021', 26 April 2021, https://vlex.com.co/vid/866596373.

36 Jose V Zapata, Daniel Fajardo Villada and Camila Del Villar, 'Superfinanciera expide reglamento sobre emisión de Bonos Verdes en Colombia', Holland & Knight, 10 September 2020, https://www.hklaw.com/en/insights/publications/2020/09/superfinanciera-expide-reglamento-sobre-emision-de-bonos-verdes.

ESG due diligence

ESG is not a one-size-fits-all proposition for every company operating in every industry and every jurisdiction. While there are measurements used across industries that are of particular importance for most companies (Foreign Corrupt Practices Act and anti-bribery, privacy and cybersecurity, climate (risk and emission), diversity, equity and inclusion (DEI), and human rights and labour practices), other ESG indicators measured by investors vary based on a company's industry or region. Sell-side advisers should guide a target company to focus on ESG by identifying:

- applicable regulatory and compliance regimes;
- areas of ESG focus particular to a region; and
- ESG initiatives that can enhance value in the target's particular industry or sector together with ESG initiatives to reduce potential risk or legal liability.

While some ESG diligence may relate to topics traditionally covered in the ordinary due diligence process, ESG due diligence typically goes further, focusing on the target's values, culture and social responsibility. For instance, traditional due diligence typically addresses the target's compliance with labour and employment laws; however, ESG due diligence may address workplace diversity, gender inequity, sexual harassment and workplace misconduct.

ESG due diligence is still evolving and there is no defined process to properly measure ESG risks associated with a target; however, sell-side advisers should prepare their clients in advance to be evaluated and rated by potential acquirers in accordance with at least one of the commonly used ESG measurement standards discussed above.

In connection with the ESG diligence process, target companies should be prepared to provide key ESG data tailored for their particular industry based on the measurement standards by one of the above-listed ESG standard organisations, including relevant information regarding the following:

- corporate social responsibility;
- compliance with international conventions and agreements regarding hazardous chemicals or banned substances;
- environmental performance;
- labour practices, including working conditions;
- DEI (equal opportunities, board diversity, gender pay gap, etc.);
- land use practices involving indigenous peoples or cultural heritage sites;
- health and safety practices;
- community health impact; and
- compliance with permits and licensing requirements.

As further discussed below, sell-side advisers can also assist target companies in establishing and implementing corporate governance initiatives where practicable in advance of a diligence process, including:

- policies regarding political contributions and government relations;
- appointment of independent directors and audit committees;
- conflicts of interest;
- related-party transaction reporting and approval;
- anti-corruption policies and procedures;
- whistle-blower protection; and
- the establishment of a code of ethics and code of conduct.

Target companies preparing for the M&A process should also develop their own system of record-keeping and evaluation of its compliance with any mandated reporting regime and compliance with the self-imposed policies described above.

Contractual protections

Representations and warranties regarding compliance with anti-money laundering laws, data privacy laws, anti-corruption laws and trade laws are customary in M&A transactions in the region, together with representations regarding compliance regimes, monitoring and compliance testing. However, Latin America may slowly start to see more specific ESG-focused provisions such as 'Weinstein clauses' (where a target represents and warrants that its officers or executives have been the subject of allegations of sexual harassment or misconduct). Additionally, other ESG-focused representations will include those regarding the target's compliance with applicable ESG policies (assuming the target has committed to comply with these standards) or representations particular to the target's industry and region regarding social, labour, health and safety, security or environmental incidents.

Notwithstanding the above, the ESG focus in M&A contracts is likely to also focus largely on ESG post-closing covenants regarding the implementation of and adherence to ESG policies and procedures, especially in the event of a partial or staggered sale or a contingent value right pricing element, such as earn-outs. To ensure a robust data gathering and reporting process in an M&A deal, the transaction should include, as a preliminary matter, a covenant to implement any of the more widely accepted ESG reporting standards (e.g., SASB, CDSB or IIRC) if the target has not already done so. The covenant can be robust and include establishing KPIs upon which to measure ESG performance and setting a timeline for implementing the ESG reporting standards along with the frequency that the data is reported and measured. Other covenants can address ESG risks pertinent to the target. For instance, acquirers might use a covenant to implement cybersecurity and data privacy initiatives, sustainably source raw materials, commit to reducing carbon emissions by a specific date, diversify the workforce, and more. The key is to ensure that the covenant emphasises the reporting and data collection efforts required to achieve these ESG goals.

Given the evidence that positive ESG results can drive long-term shareholder value, experts believe that executive incentive plans designs would be better served by including 'quantifiable' ESG measures.[37] As such, M&A transactions may also include covenants in executive compensation packages that provide incentives to drive ESG goals. However, covenant drafters should pay special attention to addressing the reliability of the ESG metrics used to quantify these outcomes. One way to avoid questionable reporting practices by executives is to peg non-executive employee compensation and promotions to ESG reporting goals (as opposed to ESG outcome). According to experts, when companies decide to incorporate ESG measures into annual incentive plans for executives, they can measure progress for between three and five years, or towards longer-term objectives when ESG goals cannot be measured over a 12-month period, such as climate-related issues that warrant a much lengthier view (10 years and longer).[38] These covenants must be structured in a way that will provide flexibility for uncertainties such as evolving market trends and ESG standards, and be limited to a focus on up to three ESG measures to guarantee focus, efficacy and compliance.

Buyers can also use pre-closing covenants and closing conditions to address ESG issues identified during the due diligence phase of the M&A transaction.[39] For example, buyers can cause the target company to adopt any of the internationally recognised ESG reporting frameworks and provide a deliverable by the closing date that shows it adopted the framework while disclosing all actual and anticipated ESG risks. In addition, buyers can request a special indemnification agreement to address all known ESG issues and risks, to be reassured and to mitigate risk pre-closing. The use of pre-closing covenants and closing conditions is particularly useful in transactions with longer wait times between signing

37 R Boffo and R Patalano, 'ESG Investing: Practices, Progress and Challenges', OECD Paris, 2020, https://www.oecd.org/finance/ESG-Investing-Practices-Progress-Challenges.pdf.

38 Kristen Sullivan and Maureen Bujno, Deloitte LLP, 'Incorporating ESG Measures Into Executive Compensation Plans', Harvard Law School Forum on Corporate Governance, 24 May 2021, https://corpgov.law.harvard.edu/2021/05/24/incorporating-esg-measures-into-executive-compensation-plans/.

39 John A Terry, et al., 'Canada: The Growing Importance of ESG in M&A Transactions', Mondaq, January 2021, https://www.mondaq.com/canada/corporate-and-company-law/1025746/the-growing-importance-of-esg-in-ma-transactions.

and closing, such as those requiring regulatory approvals (e.g., Mexican National Banking and Securities Commission approvals in Mexico or Administrative Council of Economic Defence approvals in Brazil). In deals with shorter pre-closing periods, the target company can covenant to implement an ESG compliance programme within a specified period post-closing. Notwithstanding the length of the pre-closing period, incorporating pre-closing covenants and closing conditions in the M&A agreement will ensure a smooth transition during the post-closing integration of the contemplated ESG programmes.

Post-closing integration

After completion of diligence and the closing of an acquisition, acquirers will likely implement programmes to address and monitor any ESG risks or shortfalls discovered during the diligence process (in addition to integration, compliance and monitoring of any ESG programmes already in place pre-acquisition). Acquirers will generally want to align a target's overall ESG philosophy and culture to its own by monitoring implementation and compliance of any ESG policies. ESG compliance is bespoke to each company while being guided largely by the global ESG measurement standards issued by the institutions discussed above.

However, there are certain strategies and initiatives to consider when completing a successful post-closing implementation of ESG metrics into a target operation:

- ensure that the acquired company's organisational documents and shareholder agreements contain provisions that mandate a board seat be allocated to an independent director;
- create positions for a chief sustainability officer, chief compliance officer, or both;
- empower the chief compliance officer or chief sustainability officer to coordinate ESG efforts with the organisation and oversee ESG employees;
- undertake a formal risk assessment, including contracting with third-party consultants and auditors covering the complete supply chain, and including an evaluation of resource accessibility, usage and sustainability; talent recruitment, engagement and retention; financial performance and risk; and reputational impacts;
- implement ESG data reporting and measurement systems by working with third-party consultants and auditors that have developed systems to 'quantify' ESG results, and adjust accordingly as the ESG data collection process evolves;

- draft policies and procedures in compliance with local environmental, safety and health laws and regulatory frameworks, rectify any wrongdoing and assist the company in completing any regulatory filings to comply with local laws, issuing disclosure statements (internal or external) if required and coordinating any employee terminations, as applicable;
- establish a code of conduct and code of ethics;
- implement training and communication of the new policies and procedures; and
- remain current with the legal and regulatory changes pertaining to ESG in the target's industry, and make timely updates to the policies and procedures to reflect these changes.

Additionally, while the above examples lend some insight into ESG post-closing integration, attorneys in Latin America should tailor their ESG approach to meet more specific regional needs and the regulatory environment in each jurisdiction. Ideally, where possible, ESG initiatives identified above can be part of a pre-transaction planning to emphasise a commitment to ESG prior to a sale process to uncover and remediate any systemic risks in advance of a change of control transaction or outside investment.

Conclusion

As ESG continues to evolve in Latin America, attorneys should expect to play a larger role in the analysis of more detailed, ESG-driven information and the exploration of uniquely Latin American ESG issues. With these regimes continuing to grow and develop, ESG matters will increase in importance in transaction planning, negotiation and post-closing integration. Accordingly, attorneys in the region must work to familiarise themselves with the types of issues capable of halting a deal in its tracks and remain abreast of decisions by local regulators, relevant government priorities and global trends that may be adopted in the region.

CHAPTER 9

Representations and Warranties Insurance in Latin American M&A: A Long-Awaited Alternative in the Face of Current Challenges

Paola Lozano, Ralph E Pérez and Daniel Hernández[1]

While representations and warranties insurance (RWI) is commonly used in many domestic private-target M&A deals in the US, the use of RWI in cross-border M&A transactions involving emerging markets has long been an up-and-coming trend yet to fully consolidate, especially in transactions involving Latin American targets. In recent years, RWI has gradually entered the cross-border transactional space and become an important risk allocation tool in cross-border M&A deals. Historically, RWI was often discussed but rarely used in Latin American M&A deals, mainly due to insufficient market penetration by insurance companies offering RWI in their portfolios. However, in recent years we have observed a significant increase in the frequency in which RWI is used, or at least available and seriously considered, in M&A deals in the region.

Dealmakers have been motivated to find alternatives to traditional post-closing risk allocation in Latin America because of the increased complexity of deals, the number of regulatory or court-mandated transactions and distressed divestments, the increased sophistication of passive investors that are unwilling to assume direct risk and the more competitive nature of global auction processes. Also, the current global turmoil and the environment of social unrest and political instability facing

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the globe and the region have shown that RWI can be a valuable tool to align parties' interests and expectations as to risk allocation, in a manner that may not otherwise be possible without transactional insurance.[2]

The increase in private equity-led Latin America M&A divestitures has also been a driving factor in the rising interest in RWI, because it may avoid potential misalignment between the fund life expectancy of the selling private equity fund, on the one hand, and the acquirer's expectation as to recourse, indemnification survival periods and holdback or escrow terms under the purchase agreement, on the other hand. As more region-specific funds reach maturity and the return of capital to their investors becomes imminent, the pressure increases to seek clean exits where a selling fund does not retain significant post-closing financial risk through indemnity covenants.[3]

Nonetheless, the use of RWI in Latin American M&A deals continues to be in the early stages. Therefore, aggregated data regarding the use of this tool in the region is not readily available and the specific terms and scope of an RWI policy are likely to be highly bespoke. While there is no shortage of RWI guides for the US, these resources are limited with respect to Latin America. Notwithstanding, as is the case with many M&A constructs, RWI has been transplanted from US M&A practice into Latin American M&A practice,[4] and the use of RWI should be expected to follow US practice and developments, with certain notable differences highlighted in this chapter.

As market penetration by insurance companies offering transactional insurance in Latin America continues to develop, the relative cost of RWI in Latin American deals should generally be expected to remain higher than that of RWI policies issued in US domestic transactions due to reduced competition among, and limited risk appetite from, insurers that currently offer this product in the region. Although we have seen insurer competition increasing and RWI becoming more broadly available and cost-efficient, especially in transactions with less complex target operations for which due diligence efforts may provide a greater degree of assurance as to the likelihood of unexpected material contingencies, a disparity with the US market persists.

2 See the 'Latin Lawyer M&A Roundtable' in this guide.

3 See the 'Private Equity Funds and Institutional Investors in M&A' chapter in this guide for an overview of transactions involving private equity funds and other institutional investors in Latin America.

4 For an introduction to the term 'legal transplant,' see Watson, Alan, *Legal Transplants: An approach to Comparative Law* (2nd edition, University Press of Virginia, 1993).

Against this backdrop, this chapter is intended as an overview of the main aspects that dealmakers should take into account when considering RWI and its implementation in Latin American cross-border M&A. The first section includes an overview of the 'nuts and bolts' of RWI, including the types of RWI policies available; policy period, deductible, limits and exclusions; associated cost; typical underwriting process; and key aspects of the process to make claims under the RWI policy. The second section focuses on factors that may impact whether RWI is available for a particular transaction, and the related cost of the policy. The third section includes reflections on the relative benefits that RWI can offer for both sellers and buyers, and the transaction as a whole. Finally, in the fourth section, we discuss the intersection of RWI and the purchase agreement.

'Nuts and bolts' of RWI

Types of RWI policies

RWI protects the insured party against financial losses resulting from the breach of representations and warranties (R&Ws) made by the seller or the target under the purchase agreement. There are two types of RWI policies, depending on who will be the insured party:

- a buy-side RWI policy, which is issued to the buyer as the insured party, allowing it to seek payment from the insurer for losses incurred as a result of the breach or inaccuracy of R&Ws made by the seller or the target under the purchase agreement; and
- a sell-side RWI policy, which is issued to the seller as the insured party, allowing it to seek payment from the insurer for losses incurred as a result of claims brought by the buyer against the seller for breach or inaccuracy of R&Ws made by the seller or the target under the purchase agreement.

In broad terms, both buy-side and sell-side RWI achieve the same ultimate financial effect, which is to allocate to the insurer the risk of breaches or inaccuracies of the covered R&Ws. Thus, the risk of any losses derived therefrom is shifted to the insurer and is not borne by either seller or buyer. However, the risk assumed by the insurer is not absolute as it is subject to the precise scope of the covered R&Ws and the relevant policy terms and conditions, including coverage limitations and exclusions. Therefore, as further explained below, the type of RWI policy issued in connection with a deal (i.e., sell-side versus buy-side) can be indicative of:

- the extent to which there will be recourse available to the buyer under the purchase agreement in connection with any insured breach or inaccuracy of the R&Ws; and

- the allocation of the risk that a claim under the RWI policy against the insurance company be denied.

On the one hand, sell-side RWI covers the financial risk of the seller resulting from its indemnity obligations contemplated in the purchase agreement, as it requires the carrier to pay the seller following a verified payment by the seller to the buyer with respect to an indemnity claim. Sell-side RWI policies are therefore premised on the fact that the buyer has recourse under the purchase agreement and are moot in 'no recourse deals'. Therefore, the seller generally bears the risk that a claim be denied by the carrier under a sell-side RWI policy.

On the other hand, buy-side RWI eliminates or significantly narrows the seller's indemnity obligations under the purchase agreement, as the buyer looks mostly to the RWI carrier instead of the seller for recovery in the covered areas. A buy-side RWI policy may be issued regardless of whether the buyer has recourse against the seller under the purchase agreement for the covered matters, in addition to the RWI. Absent recourse against the seller, the buyer will exclusively bear the risk that a claim under a buy-side RWI policy be denied by the insurance company. If the buyer has recourse against the seller, the seller will likely bear this risk to the extent of its indemnification obligations under the purchase agreement, especially if the parties have agreed that the buyer must first seek recovery from the buy-side RWI and may only collect from the seller to the extent it is unable to recoup under the RWI.

Buy-side RWI policies are overwhelmingly used more than sell-side RWI policies because, among other reasons, contingencies known by the insured party are typically excluded from coverage under RWI policies (see 'Exclusions', below). Considering that the buyer is less likely to be aware of contingencies of the target business than the seller, buy-side RWI policies are expected to entail a more narrow range of excluded contingencies due to knowledge of the insured party. Not surprisingly, over 97 per cent of the transactions in which RWI is used involve a buy-side RWI policy.[5]

5 Woodruff-Sawyer & Co, 'Guide to Representations and Warranties Insurance', 2023, p. 9. In addition, according to the most recent market survey on private target M&A deals in the US published by the American Bar Association as at the time of writing, 95 per cent of the transactions in which representations and warranties insurance was used from 2018 to the first quarter of 2021 involved a buy-side RWI policy (American Bar Association, Business Law Section, 'Private Target Mergers & Acquisitions Deal Points Study', December 2021 (ABA 2021 Survey), p. 122).

Cost

The main cost components of RWI are the premium, the broker fee, the underwriting fee and taxes payable on the policy.

The premium is a one-time payment to the carrier, usually expressed as a percentage of the RWI policy coverage limit. Premiums in the US typically range between 2.5 per cent and 3.5 per cent of the policy limit.[6] However, as noted above, costs associated with RWI issued in Latin American deals tend to be higher than in the US due to reduced penetration and competition among insurers in the relevant markets. Although there is no aggregated data for RWI in the region, premiums in Latin American deals should be expected to be between 3.5 per cent and 5 per cent of the coverage limit.[7]

The amount of the premium will be impacted by the terms of the RWI policy, the transaction terms and the specific circumstances of the target, including the jurisdiction and industry in which it operates, perceived legal certainty and macroeconomic risk (including currency risk). Insurance companies are willing to agree on enhancements to the policy to cover some of the excluded items (see 'Exclusions', below), for an increase in the premium. Thus, the amount of the premium in each case will ultimately depend on the facts and circumstances at hand.

RWI policies issued in Latin American deals should bear no difference in cost when it comes to RWI broker fees (typically ranging in the US in the low tens of thousands of dollars and often absorbed within the RWI premium if a policy is ultimately bound) and taxes on the policy (which typically are dependent on the registered address of the insured party). The insured party is usually required to pay an underwriting fee (sometimes referred to as a 'diligence fee') to the carrier to cover diligence and other costs incurred in the underwriting process, including outside counsel engaged by the insurer for diligence purposes, if any. The underwriting fee in the US typically ranges between US$25,000 and US$50,000.

Regardless of whether an RWI policy is buy-side or sell-side, the parties can negotiate the allocation of the premium and other RWI costs between buyer and seller. In a competitive sale process, it is not uncommon for the seller to ask the buyer to cover all RWI cost, including the full amount of the premium. However, if the buyer has more leverage, it is usually well advised to request that

6 See, for example, Marsh LLC, 'Transactional Risk Insurance Map', 2023, p. 2 (indicating that, as at Q1 2023, premium rates in the US and Canada range between 2.7 per cent and 3.5 per cent of the policy limit).

7 ibid.

the seller assume or share the costs of the RWI, under the argument that the RWI is covering risks that would otherwise need to be covered by the seller under indemnity provisions in the purchase agreement. Pursuant to the American Bar Association's latest biannual market survey on private target US M&A deals, the seller assumed all or part of the RWI costs in at least 32 per cent of the deals using RWI between 2020 and the first quarter of 2021 (despite 95 per cent of the relevant policies in that period being buy-side RWI).[8] According to a recent survey by LexisNexis, at least 17 per cent of the acquisition agreements in 2022 expressly required sellers to assume some (15 per cent) or all (2 per cent) of the cost of the policy premium.[9]

Retention

RWI policies include a deductible, referred to as the 'retention'. In the US, the retention usually ranges between 0.5 per cent and 1 per cent of the deal value, although higher deductibles may apply for smaller transactions or in special circumstances.[10] The retention in RWI policies issued in Latin America should be expected to be around 1 per cent of deal value. However, the retention may be higher depending on the relevant jurisdiction and specific circumstances of the target business (going up to 2 per cent in some cases). Many RWI policies in the US provide for a drop of the retention (usually by 0.5 per cent) after a specified period of time has passed since the policy was issued (usually on the first anniversary of the closing), but some carriers may not be willing to offer a drop of the retention in Latin American deals.[11]

In a competitive environment, the seller may require that the buyer assume the risk below the retention, as would be the case in a no recourse deal. Conversely, when the buyer has more leverage, it may require that the seller provide indemnification for breaches of R&Ws below the retention, subject to customary limitations on indemnity, such as a de minimis amount, as applicable. Furthermore, if the seller

8 ABA 2021 Survey, op. cit., p. 124.

9 LexisNexis, 'Market Trends 2022: Representations & Warranties Insurance', April 2023, p. 5.

10 See, for example, Marsh LLC, op. cit., p. 2 (indicating that, as at Q1 2023, the retention in the US and Canada ranges between 0.75 per cent and 1 per cent of the deal value).

11 ibid.

is liable for all or some amount of the losses below the retention and arising from breaches of R&Ws, a buyer with negotiation leverage may require a holdback or escrow in connection therewith.[12]

Recourse against the seller for breach or inaccuracy of the R&Ws covered under the RWI (e.g., with respect to all or some amounts below the retention) has the potential of lowering the cost of the RWI, in the form of a reduction in the premium. Insurance companies will have more confidence in the quality of the R&Ws and in the seller's diligence and overall process in granting R&Ws if buyer has recourse against the seller. Insurance companies assume that, if the seller has 'skin in the game', it will be more zealous in negotiating the specific wording and relevant qualifiers of R&Ws and in making appropriate disclosures of exceptions thereto. The seller's indemnity obligations usually do not need to be substantial relative to the deal value or even the RWI policy limit for the insurance company to be able to offer a discount in the premium, as long as the RWI carrier deems these obligations to be enough for the seller's interests to be aligned with those of the insurer when negotiating the relevant terms of the purchase agreement. According to SRS Acquiom's 2023 M&A Deal Terms Study, the presence of RWI significantly increases the frequency of deals with indemnification clauses providing for no indemnity basket at all (e.g., only 6 per cent of deals with no RWI in 2022 included no indemnity basket, while 40 per cent of deals with RWI in 2022 included no indemnity basket).[13] The notable decrease of the use of indemnity baskets in the presence of RWI evidences a willingness to shift some or all of the risk below the retention to the seller.

The RWI policy usually does not include a de minimis amount. However, significant materiality thresholds in the scope of the buyer's due diligence review may prompt certain carriers to increase the retention or, less market standard in the US (but more common for European insurers), attempt to include a de minimis amount in the policy.

Policy period

In sell-side RWI policies, subject to a specified maximum term, the policy period tends to match the survival period of the seller's indemnification obligations under the purchase agreement, because the insured risk stems from these obligations. In

12 See the 'Indemnity Escrows and Other Payment Guarantees' chapter in this guide for an overview of escrow agreements, holdback provisions and other guarantees that may be used in the context of M&A transactions in Latin America.

13 SRS Acquiom, '2023 M&A Deal Terms Study', 2023, p. 66.

buy-side RWI policies, however, it is more common in the US to see a three-year policy term for operational and non-fundamental R&Ws and a six-year policy term for tax and fundamental R&Ws.[14] No aggregate comparable data is available specifically for RWI policies issued with respect to Latin American deals. The rationale for policy periods may be impacted by the underlying applicable statute of limitations and other considerations that are specific to each underlying jurisdiction. Nonetheless, we would not expect the aggregate trend on policy period to be substantially different in Latin American deals from what is observed in policies issued for US deals, especially considering that most insurers offering RWI in Latin America are based in the US.

Coverage limit

The total coverage limit of RWI policies issued with respect to M&A transactions in the US usually ranges between 10 per cent and 25 per cent of the deal value. Most carriers are open to a policy enhancement to cover breaches of true fundamental representations (i.e., title, organisation, good standing, authorisation and capacity) beyond the general limit of the policy, often up to 100 per cent of the deal value, in exchange for an increase in the premium amount.

As with other aspects of RWI policies issued in respect of M&A deals in Latin America, there are no statistics readily available in connection with typical coverage limits under these policies. Some RWI brokers say that RWI policies issued with respect to Latin American deals have lower limits, as a percentage of the deal value, than RWI policies issued in respect of US deals, due to limited RWI carrier competition and appetite. Others maintain that RWI policy limits in Latin America tend to be higher, as a percentage of the deal value, because of smaller deal sizes. Still, others believe that the policy limits in Latin America are comparable to those in the US.

Exclusions

RWI generally covers unexpected financial risk derived from breaches of R&Ws. Therefore, RWI is not designed or intended to cover, and does not cover, breaches of covenants or price adjustment payments. However, coverage through R&Ws on the underlying subject matter of some covenants may be obtained under RWI. For instance, the risk of breach of seller's interim operating covenants often can be covered indirectly, through an 'absence of certain changes' R&W.

14 SRS Acquiom, *Tales from the M&A Trenches, Post-Closing Practices to Mitigate Post-Closing Risks* (5th edition, March 2019), p. 150.

Insurers only protect against unknown risk. As is the case in the US and other jurisdictions, RWI policies typically do not cover breaches of R&Ws derived from known or expected issues, including those revealed in the diligence process or identified in the disclosure schedule.[15]

There also are various subject areas that RWI carriers will generally exclude from RWI policies, including data protection and cyberattack matters, compliance with certain labour and employee benefits laws (including on wages and pension matters), certain tax matters (such as open audits, transaction-related taxes or the ability of the target or buyer to, or time frame in which the target or buyer may, utilise net operating losses), product liability, certain environmental matters (such as pollution and handling and release of hazardous materials), and fraud by the insured party (in the case of buy-side RWI policies, breaches of covered R&Ws that occur due to fraud or fraudulent misrepresentation by the seller are usually covered, subject to the insurer's subrogation right with respect to any claims involving fraud by the seller). Additional subject areas that RWI carriers almost always seek to exclude for Latin America RWI policies include bribery and corruption, money laundering, and expropriation risk. Separate insurance policies and products may be available to cover some, but not all, of these exclusions.

Among other issues, quantifying the underlying risks of these excluded matters is extremely difficult for RWI carriers on the basis of transaction diligence, and although some of the excluded items may be perceived as having a low likelihood of occurring, most of the risks (e.g., anti-corruption) have been more pervasive in Latin America than in other jurisdictions in recent times. Furthermore, when the risk materialises, it tends to have a severe and long-lasting negative impact not only on the target but also on the buyer.

Further, insurers may seek to have additional exclusions on a jurisdiction-specific, industry-specific or deal-specific basis. These exclusions may include specified matters that in the opinion of the insurer were not sufficiently reviewed during diligence, or items relating to diligence findings.

Depending on how competitive the M&A process is, the buyer may require that the seller provides indemnification for excluded items under the RWI policy and may even require an escrow or holdback to guarantee liquidity for these risks.

15 We have confirmed in discussions with brokers that in certain instances, issuers have been willing to broaden coverage in the US for certain interim breaches (i.e., breaches of R&Ws first arising between signing and closing, of which the insured party has actual knowledge as of the closing). Time will tell whether these coverage enhancements will be available with respect to M&A deals in Latin America.

Underwriting process

Typically, the insured party (likely the buyer) will engage an RWI policy broker. The broker will then reach out to potential insurers and provide them with limited key information regarding the deal, which is generally only disclosed after the insurers sign a customary non-disclosure agreement or joinder to the buyer's non-disclosure agreement with the target or the seller. The information typically shared with the insurers includes the management presentation or confidential information memorandum, recent target financial statements, the draft purchase agreement, the proposed purchase price and the requested coverage. Insurers that are interested in issuing a policy for the relevant deal will then provide the broker with quotes and the broker will prepare a summary comparison chart of proposed key policy terms, including coverage limit, retention, premium, exclusions, enhancements and areas of required heightened diligence (which may ultimately result in additional exclusions). The quotes will typically be subject to confirmatory due diligence by the insurer.

Once the prospective insured party has selected a preferred insurer, the insurer may require the execution of a 'non-binding indication letter', setting forth the key terms of the policy, in addition to payment of the underwriting fee. In competitive auctions and other circumstances in which the buyer has not entered into an exclusivity agreement with the seller or target with respect to the transaction, a buyer seeking an RWI policy may be required to pay an exclusivity fee to the insurer to proceed with the underwriting. Pre-exclusivity underwriting is not very common and therefore the exclusivity fee charged by carriers can be material (e.g., low to mid hundreds of thousands of dollars), depending on market capacity and how much competition and appetite there is for the target business. However, the exclusivity fee is likely to be credited against the premium if a policy is issued thereafter.

The insurer will require access to the data room and a copy of all due diligence reports (including from outside counsel, accounting firms and other advisers) and a copy of the disclosure schedules, all of which are usually expressly provided on a 'non-reliance basis.' Thereafter, the prospective insured party and the insurer will (1) hold an 'underwriting call' to discuss the status, scope and findings of the diligence review and other items relevant to the negotiation of the purchase agreement and the scope of the R&Ws (the insurer may follow up with specific questions after the call), and (2) negotiate and agree on the terms of the RWI policy, based on a form provided by the insurer.

The RWI policy can be bound prior to signing of the purchase agreement or between signing and closing, in each case, effective as of the closing. Buyers seeking a buy-side RWI are well advised to secure the terms of the RWI prior to signing. The purchase agreement does not typically include a condition to closing for the benefit of the buyer on an RWI policy being actually obtained, because it is in buyer's control to secure the policy prior to signing, assuming RWI is available to begin with.[16] Further, as discussed, deals involving RWI often have no recourse or limited recourse against the seller. Therefore, the buyer should be the party most interested in confirming the availability and terms of the RWI (its only expected source of recovery), prior to executing the definitive agreements. When the terms of the RWI policy are agreed prior to the execution of the purchase agreement, the buyer and the insurer will typically enter into a binder of insurance, which will include a draft of the policy as an exhibit thereto and provide for the issuance of the policy upon satisfaction of certain customary conditions, including:

- payment of the premium in full;
- payment of the underwriting fee in full;
- consummation of the closing under the purchase agreement;
- absence of any amendments to the purchase agreement that adversely impact the insurer;
- a certificate from the insured party on the absence of knowledge of any breach of R&W (referred to as a 'no claims declaration'); and
- delivery to the insurer of an electronic copy of the data room and copies of final due diligence reports.

Prior to issuing the policy at closing, the insurer will require a 'bring-down call' with the insured party's deal team and third-party advisers on outstanding diligence questions and to enquire whether there have been any additional diligence findings since the date of the diligence reports provided to the carrier. Absent materially adverse issues, the terms of the policy are not typically revised after that call or the finalisation of the insurer's diligence.

The duration of the underwriting process will depend on whether the RWI carrier is willing and able to rely on the parties' diligence reports, rather than require full-blown diligence by its independent US and local counsel. In the US, the entire process from engagement of the RWI broker to a final negotiated RWI policy can sometimes be done in as little as two weeks, assuming no full-blown independent diligence by the insurer. Some brokers indicate that the RWI process

16 Pursuant to the ABA 2021 Survey, only 12 per cent of deals referencing RWI in 2020 to the first quarter of 2021 included a stand-alone condition for the benefit of the buyer on obtaining RWI. Twenty-three per cent of those deals included this condition for the benefit of the seller and 66 per cent of the deals did not include any stand-alone condition on RWI. See ABA 2021 Study, op. cit., p. 125.

in Latin America is only a couple of days longer than that for a US policy, while others suggest it may take an additional three weeks. Other than possibly taking longer to complete, the process for a Latin America RWI policy is no different than that for a US policy.

In a highly competitive auction, the seller may indicate to the bidders that it will be providing no indemnity or very limited indemnity and will encourage them to use RWI as the sole source of recovery. Moreover, in that type of auction (especially in jurisdictions where availability of RWI is not clear or where there is uncertainty that it would be available at reasonable cost), the seller is generally well advised to engage a broker early in the process to confirm availability of RWI for the transaction. Sellers may also seek to pre-package a buy-side RWI policy that would be presented to bidders along with other transaction materials (typically during Phase II of the auction), which not every carrier may be willing to do in every deal (particularly US carriers) and should be expected to be subject to confirmation of the identity of buyer and the final terms and conditions of the deal. Bidders should bear in mind that they are not required to engage the broker that has worked with the seller in confirming availability of RWI or pre-packaging the RWI policy or to purchase the RWI policy from any of the seller's proposed carriers. Bidders can, of course, engage a different broker to survey the market and confirm whether better terms (including better coverage or more efficient costs) can be independently obtained. The merits of going down this route should be carefully assessed, considering, among other things, (1) time constraints; (2) RWI market depth and likelihood that other brokers and carriers may offer better terms for the particular transaction; and (3) the competitiveness of the auction, including whether the bidder may put itself at a disadvantage compared to other bidders that may go with the pre-packaged broker, carrier and policy, as applicable, especially if recourse against the seller in lieu of RWI coverage is on the table, because the seller will need to educate itself on the terms and reliability of the bidder's proposed policy and carrier.

Claims process under the RWI policy

RWI carriers usually have standardised and relatively expeditious processes to review claims. Insurers typically approach the claim process with a much more commercial perspective than sellers may approach indemnity claims, because at the end of the day handling these claims is inherent to the insurers' business model. The last thing an insurer wants is to build a reputation for being unreasonable in the handling of claims, as insurers are continuously competing for business in future deals, potentially involving the insured parties making claims under existing policies. Insured parties who are repeat players in the M&A space should also be wary of earning a reputation of being difficult to deal with, as insurers may factor in that reputation when assessing the availability and cost of future RWI policies issued to those parties.

The claim process is typically kicked off by the delivery of an initial claim notice by the insured party, followed by the insured party's assessment of the breach and incurred loss. Thereafter, the insurer and the insured party will discuss an investigation plan, often including a preliminary investigation by the insurer, followed by information and document requests. Finally, the insurer will issue a coverage position and negotiations will take place, as needed.[17] The majority of claims are resolved within one year, with approximately a quarter of the claims being resolved within six months.[18] Claims issued with respect to assets in Latin America may take longer, due to expected reduced familiarity of the carriers with the underlying jurisdictions compared to the US. The insured party is often encouraged to be forthcoming with relevant information required to assess the breach of R&W and the loss incurred, relative to the level of information that it would otherwise share with the seller in connection with an indemnity claim. The amount of time it will take to resolve the claim will depend to a great extent on information flow, in addition to the complexity of the claim.

Pursuant to recent data from AON on RWI policies issued to AON clients, 18 per cent of RWI policies issued in 2015–2021 resulted in at least one claim by the insured party under the policy. The most frequent breaches of R&Ws cited as a basis for these claims were breaches of the R&Ws on compliance with laws (15 per cent of claims) and on financial statements (14 per cent of claims). However, claims for breaches of R&Ws on compliance with laws amounted to only approximately 8 per cent of all recovered losses, while breaches of R&Ws on financial statements and material contracts amounted to 41 per cent and 32 per cent of all recovered losses, respectively, because damages arising out of breaches of R&Ws on financial statements and material contracts tend to be sought by insured parties beyond a simple dollar-for-dollar calculation.[19]

17 M&A Insurance presentation by AON to Skadden, April 2022.

18 See AON, 'Representations and Warranties Insurance Claims Study; an analysis of claim trends, data and recoveries', 2020, p. 23.

19 AON, '2023 Transaction Solutions Global Claims Study', 2023, pp. 6–9.

Insurability factors

There are several factors that may impact the RWI carriers' appetite to issue an RWI policy and the cost thereof. Considering the limited offerings of RWI alternatives in the Latin American M&A space, sellers and buyers should seek to structure the deal around these factors to increase the likelihood that RWI may be obtained and reduce the cost at which it may become available. These factors include:

- a well-regarded ultimate beneficial owner of the insured party;
- a sophisticated insured party with an established track record in M&A, such as private equity funds, preferably based in the US or another jurisdiction with high historical deal flow;
- a simple target business model that is not heavily regulated;
- sophisticated counsel and accountants involved in the transaction, performing a customary due diligence process, and availability of a data room and US-style detailed due diligence reports from these advisers;
- an English-language acquisition agreement governed by US law, UK law or the law of another jurisdiction with a robust body of case law on M&A matters;
- high-quality terms and conditions under the purchase agreement; and
- arm's-length negotiation of the R&Ws, preferably including some recourse against the seller for any breach thereof (e.g., with respect to losses below the retention).

The above list is non-exhaustive. In essence, insurers welcome any deal trait that enhances the predictability of contingencies, legal certainty or the likelihood that any material contingencies have been identified during due diligence.

Sellers expecting bidders to obtain RWI should make sure that the factors that they can control are structured in a manner that favours the availability of RWI at a reasonable cost (e.g., engaging top-notch advisers, selecting an applicable law with an established body of M&A case law that is familiar to the RWI carriers, preparing transaction documents in the English language, conducting vendor's due diligence and documenting a robust process for disclosure of contingencies). As it is, RWI carriers are already cautious on the basis of factors that tend to be out of the control of the parties. Each market is different, and the common perception of higher political and economic volatility – including widespread corruption scandals, which tend to increase fears of fraud – may cause RWI carriers to be more conservative and increase prices in emerging markets. Similarly, less deal flow and higher perceived uncertainty on the underlying applicable law of the R&Ws' subject matter also makes it more challenging to put a price tag on unknown risks. While RWI policies have been implemented in a broad range of industries across Latin America, not all countries are regarded as equal by RWI carriers. For example, it appears that Brazil, Chile and Mexico have historically had higher levels of RWI carrier interest than other significant jurisdictions, such as Argentina, Colombia and Peru.

Relative benefits of RWI

Outlined below are some of the main benefits that RWI brings to the table for each of the parties and the transaction as a whole.

Benefits to the transaction and both parties

RWI offers an important risk allocation solution and can render significant benefits to both buyer and seller and to the transaction as a whole, regardless of the type of policy in place (i.e., sell-side or buy-side) or the allocation of cost thereof. The main and most obvious benefit is that it aligns otherwise incompatible interests and expectations, allowing for a clean (or cleaner) exit of the seller from the target business, while at the same time affording buyer protection against unknown contingencies that could otherwise take a premature significant toll on the valuation of the target, in the absence of recourse.

RWI also reduces transaction costs by expediting and simplifying the negotiation of the purchase agreement between the parties, particularly with respect to the R&Ws, and by potentially eliminating or considerably narrowing discussions on indemnity and escrow.

RWI can also benefit both sellers and buyers in an M&A transaction with multiple sellers, where sellers – whether as a matter of policy or simple financial wherewithal – do not offer joint and several liability for indemnities. RWI obviates the need to pursue multiple parties for varying percentages of losses and allows for a single process with the RWI carrier. This is particularly handy if some of the selling entities are unaffiliated minority and passive investors who may be reluctant to grant indemnification on the basis of operational R&Ws negotiated by the controlling shareholder, with respect to underlying matters of which the minority or passive investors have limited or no knowledge or ability to control.

Benefits to the seller

RWI eliminates or reduces the seller's financial risk for losses arising out of breaches of R&Ws under the purchase agreement. The seller's rate of return on investment at closing is maximised because:

- in the absence of recourse, the buyer is not required to discount the purchase price on the basis of contingencies that have not materialised and would be covered under the RWI policy;

- the seller's post-closing exposure is eliminated or significantly reduced; and
- the need for a holdback or escrow dissipates, maximising the amount of consideration actually received by the seller at closing. For instance, according to SRS Acquiom's 2023 M&A Deal Terms Study, the average indemnity escrow amount in 2022 drops from 11.5 per cent of the transaction value in deals with no identified RWI to 1.2 per cent of the transaction value in deals with an identified RWI.[20]

As mentioned above, RWI allows selling private equity funds, and other institutional investors reaching maturity and relevant milestones for return of capital to their investors, to liquidate their investment in the target and distribute proceeds, without pending indemnity obligations that would delay an otherwise clean fund wind-up and dissolution. The authors have experience with deals in which specialised private equity funds at the end of the applicable fund life have been able to successfully close deals in which RWI was used to allow for a clean exit, including deals in the power and energy space.

Finally, RWI can be a powerful tool to facilitate deals with financially distressed sellers. Distressed sellers' creditworthiness does not provide sufficient assurances for effective recourse. Also, these sellers likely need to receive the proceeds of the transaction at closing to disburse them shortly thereafter to creditors or use them to cover critical operational needs. RWI provides a solution for both of these issues by eliminating or reducing reliance on recourse against the seller and providing buyer with the ability to look at the insurer for creditworthiness and liquidity risks, instead of the seller.

Benefits to the buyer

Because the buyer looks to the RWI carrier instead of to the seller for recovery in the covered areas, as noted above, RWI significantly reduces a buyer's creditworthiness risk, which would otherwise be largely dependent on the identity and financial wherewithal of the seller.

RWI can be a useful tool for a buyer entering a Latin American market for the first time. This type of buyer often keeps much of the target business's existing management in place after the closing and may structure the transaction so that the seller keeps an ownership stake, even if temporarily, in the target business post-closing. Under those circumstances, the buyer's assertion of an indemnity

20 SRS Acquiom, '2023 M&A Deal Terms Study', op. cit., pp. 78–79.

claim could sour its relationship with its new employees and partner. A buy-side RWI policy might enable the buyer to avoid this awkward situation, since the buyer would make the claim to the RWI carrier.

In a hotly contested auction, a prospective buyer can make its bid stand out by easing the seller's indemnity obligations in reliance on a buy-side RWI policy. This is especially true in Latin American M&A because not all bidders are likely to consider RWI, as RWI is not yet as common and many bidders are unfamiliar with, and even sceptical of, the benefits of RWI.

If completed prior to signing, the RWI underwriting process may enhance the buyer's diligence efforts, as it may put the focus on and uncover certain risks that may have not been otherwise identified in diligence.

As mentioned above, RWI also simplifies the process that the buyer is required to undergo to recoup losses incurred due to a breach of R&W, especially in transactions that would otherwise have involved recourse against multiple sellers. In Latin American cross-border M&A transactions, the seller or its assets are often located in jurisdictions (or multiple jurisdictions, including in the event of multiple sellers) that have complex foreign judgment enforcement rules, involving lengthy and costly recognition proceedings. In the absence of RWI, the buyer would be required to invest significant time and effort in obtaining recognition and enforcement of any judgment before being able to recoup.

The intersection of RWI and the purchase agreement

In some transactions, the purchase agreement does not include any references to the RWI, despite one of the parties using RWI. In these cases, it is likely that the insured party will independently obtain the policy and assume all costs thereof. However, although not strictly necessary, there are certain provisions that the parties should seek to include in the purchase agreement in connection with the RWI.

If the insured party has not obtained a binder of insurance prior to signing, it should seek to include covenants in the purchase agreement requiring the other party to reasonably cooperate and provide assistance in the process to obtain the RWI. As mentioned above, if the buyer has substantial leverage in the negotiations, it may attempt to include a stand-alone condition to closing on actually obtaining an RWI policy, but this condition is not customary and may significantly diminish the standing of a prospective buyer's bid in a competitive auction.

If the seller has agreed to indemnification obligations in the absence of RWI coverage and a binder of insurance has not been entered as of the execution of the purchase agreement, the seller should seek to include covenants requiring the buyer to use some level of efforts to obtain the RWI.

In any event, the seller is well advised to include provisions relating to the confidentiality of the information to be provided to the insurer, and the handling thereof, including the requirement that the carrier enters into a customary non-disclosure agreement or a joinder to the non-disclosure agreement executed by the buyer in connection with the transaction.

If the parties will share some or all of the costs of the RWI policy (e.g., the premium or the broker or underwriting fees), provisions and covenants should be included to that effect. For example, if the buyer will obtain a buy-side RWI policy but the seller will share some of the costs thereof, the buyer may seek to include these costs as transaction expenses to be deducted from the purchase price to be paid to the seller at closing.

In the event that the seller is granting recourse to the buyer in the absence of coverage under the RWI policy, whether for matters below the retention or exceeding the coverage limit, upon coverage being denied by the insurer or with respect to exclusions under the RWI policy, the indemnification provisions should be revised accordingly to reflect any agreed-upon recourse hierarchy[21] and the scope of any indemnification obligations of the seller for matters not within the scope of the RWI policy. Areas of frequent debate between the parties in the presence of RWI include whether the seller should be liable to the buyer for breaches of fundamental representations or certain key areas excluded from the RWI policy (e.g., bribery and corruption), because the underlying subject matters tend to be within the seller's control and the financial consequences for the buyer upon a breach thereof tend to be dire.

The negotiation of the scope of the R&Ws should not be heavily impacted by the presence of RWI, other than the fact that the seller may be more amenable to broader R&Ws where there is no or limited post-closing recourse against the seller in connection therewith. Nonetheless, the scope and quality of the R&Ws in the presence of RWI tends to follow market practice because insurers will likely exclude coverage for atypical R&Ws or offer to cover broader R&Ws at an additional cost. Also, the seller should be expected to continue to be careful not to compromise closing certainty by agreeing to an overly broad set of R&Ws and increasing the risk that the agreed-upon standard for the 'bring-down' of the R&Ws at closing is not satisfied.

21 Pursuant to the ABA 2021 Survey, in 2020 to the first quarter of 2021, 38 per cent of deals in which RWI was used but was not the buyer's sole source of recovery required that the buyer first pursue a claim under the RWI prior to being able to recover from the seller. See ABA 2021 Survey, p. 128.

Other provisions that may be present in the purchase agreement in connection with the RWI include clarifying language to the effect that survival provisions under the purchase agreement do not impact the RWI policy period; and in the presence of a buy-side RWI policy, covenants requiring the buyer not to obtain an RWI policy providing for subrogation rights against the seller other than in the case of fraud, and requiring that the buyer does not agree to amendments to the RWI policy that adversely affect the seller, including with respect to subrogation rights.

The RWI policy is often self-contained as to the defined terms and other provisions that trigger coverage thereunder (other than the covered R&Ws, which are contained in the purchase agreement and included by reference), including with respect to the definition of covered losses, events constituting a breach of R&W, knowledge and other exclusions. However, in deals in which a buy-side RWI policy is put in place in addition to indemnification obligations granted by the seller, the RWI policy may be informed by the relevant provisions and defined terms in the purchase agreement (e.g., the definition of 'losses'). In those cases, the buyer should be careful not to accept limitations to the relevant defined terms and provisions that it is not willing to accept with regard to the RWI carrier. The RWI policy usually follows the materiality scrape provisions in the purchase agreement, for the purpose of determining whether there has been a breach of a R&W and the extent of the losses incurred.

Conclusion

With its expected increased prominence, it is timely for dealmakers with roles in the premier Latin American M&A transactions to brush up on RWI. As long as carriers continue to be willing to offer RWI at an accessible cost, the current global and regional environment of economic growth uncertainty, social unrest and political instability can incentivise the use of RWI, because:

- sellers will be looking for a clean exit (in particular private equity funds reaching maturity) and will be increasingly reluctant to offer substantial recourse in the face of current uncertainty;
- the volume of distressed M&A transactions could increase, forcing buyers to seek alternative sources of recovery; and
- US-based insurers provide a solution to creditworthiness and country risk, particularly in transactions involving local sellers.

As a result of RWI carriers warming up to the particular conditions of dealmaking in Latin America, including market, political and economic volatility, and the increase in deal flow and deal complexity in recent years, we expect RWI carrier competition to continue to increase in the region, and we encourage parties to M&A deals to explore the availability of RWI, as reasonable costs and other terms and conditions are now available for many Latin American deals. That said, this may not be true for every deal, and Latin American dealmakers should proceed with caution and work with their RWI brokers as early as possible to confirm whether RWI is available to them at an acceptable cost under the specific circumstances.

CHAPTER 10

Public M&A, Hostile Takeovers and Shareholder Activism

Hans Peter Goebel Caviedes and Carlos Rodolfo Ríos Armillas[1]

In the dynamic Latin American financial landscape, the securities markets have undergone significant changes, impacting players and regulations in the region's key countries, such as Mexico, Brazil, Colombia and Argentina. Regulatory changes have reshaped how these markets operate, with the goal of achieving greater transparency and stronger supervision. Notably, Mexico stands out with the rise of nearshoring, a trend that has attracted foreign investment and has the potential to increase market liquidity and issuance of securities. The development of artificial intelligence will create new challenges and opportunities, prompting merger and acquisition (M&A) activity across various sectors.

Despite promising opportunities, obstacles affecting investors' confidence are created by economic and political uncertainty in the region, as well as challenges presented by evolving regulations. However, amid these challenges, real prospects are emerging in growth sectors such as technology, e-commerce, fintech and renewable energies, bolstered by the region's willingness to welcome foreign investment as a source of funding.

This chapter discusses three main components of public company activity: initial public offerings (IPOs) and dual listings, hostile takeovers and shareholder activism. This chapter heavily focuses on Mexico and, to a lesser extent, Brazil as the largest economies and strongest markets in the region.

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The securities markets in most Latin American countries require profound changes in several areas to improve their lacking liquidity and depth, and their low trading volumes compared with some of their counterparts in other parts of the world.

With a more developed equity capital market and more public companies participating in that market, public M&A transactions could increase significantly across the region.

IPOs and dual listings

A company considering going public in equity capital markets through an IPO must weight up the advantages and disadvantages of carrying out this process in light of its specific circumstances and long-term interests. The following are some of the main advantages of becoming a public company, according to lawyer David Feldman:

- access to capital from investors is gained by issuing shares in the equity capital markets, which is beneficial if the cost of this capital is lower than obtaining financing from the banking system. There are also fewer restrictions and covenants required by private equity or venture capital investors;
- current shareholders can gain liquidity with the sale of a portion or all of their shares;
- growth can be pursued through acquisitions, strategic partnerships or other corporate transactions; and
- stock options and other equity incentives can be offered to attract and retain talented members of the management team.[2]

The disadvantages include the following:

- shareholder value is gained by short-term results (reported every quarter) meeting or beating the expectations of the market rather than on long-term goals;
- financial and corporate information, which will be scrutinised by authorities, investors and market analysts, must be shared;
- the costs of carrying out an IPO and the regulatory costs and expenses of running a public company are high; and
- in some jurisdictions, public companies are easier targets for lawsuits, including from shareholders or investors, as well as class actions.

2 Feldman, David N, *Regulation A+ and Other Alternatives to a Traditional IPO* (Wiley, 2018), pp. 1–9.

Going public can boost the growth of a company, but in addition to weighing the advantages and disadvantages, external factors such as the geopolitical situation must be considered to ensure a successful debut in the equity capital markets. During 2022 and 2023, the challenging global economy and political uncertainty in several Latin American countries have cooled the market, heavily affecting IPO activity in the entire region.

In 2021, Brazil experienced robust IPO activity with 45 IPOs, seeing its highest activity level since 2007 (which had 64 IPOs),[3] primarily due to low interest rates and high liquidity. By contrast, there was a sharp decline in 2022, with only one IPO on the Brazilian securities exchange, caused by surging rates that curbed investors' risk appetite, due to concerns of a potential recession and uncertainty regarding the presidential elections held in October 2022, in which Luiz Inácio Lula da Silva was elected as president.

Mexico's IPO market has slowed considerably over recent years and there have been no IPOs due to the lack of adequate incentives, poor regulatory policies and the covid-19 pandemic. Further, listed companies have carried out, or are in the process of making, tender offers to delist from the Mexican securities exchanges, including Aeroméxico (the oldest operating Mexican airline), Grupo Lala (one of the largest dairy companies in the world), Bio Pappel (the biggest producer of paper and paper products in Mexico and Latin America), Bachoco (one of the biggest poultry companies in the world), IENova (a developer, constructor and operator of energy infrastructure in Mexico) and Grupo Sanborns (a leader in retail sales). The reasons for this wave of delistings are varied but would likely constitute one of the following: low financial valuations caused by a deterioration in market expectations; financial problems or debt restructurings; mergers or other corporate transactions; or a preference for listing in more liquid markets (for example, the United States).

The Mexican government knows that the Mexican securities market lacks depth and that there is a need for agile and efficient processes to make the offering of securities more flexible and generate incentives for small and medium-sized companies to access and use the Mexican securities market as a source of financing

3 '2021 EY Global IPO Trends Report', https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/ipo/ey-2021-global-ipo-trends-report-v2.pdf; and 'EY Global IPO Trends 2022, https://assets.ey.com/content/dam/ey-sites/ey-com/en_gl/topics/ipo/ey-global-ipo-trends-2022-v1.pdf.

for potential growth. On 28 April 2023, the Mexican Senate approved a bill to amend, repeal and supplement certain provisions of the Securities Market Law and the Investment Funds Law (the Amendment Bill).

The purpose of the Amendment Bill is to create alternative ways to participate in the Mexican securities market by:
- simplifying the registration process in the Mexican National Registry of Securities (RNV) for small and medium-sized companies;
- regulating the participation of the credit rating agencies, brokers and securities exchanges in the simplified registration;
- changing the corporate regime for issuers;
- incentivising environmental, social and corporate governance (ESG) policies;
- introducing regulation for setting up hedge funds in Mexico; and
- aligning with international principles and best practices to promote greater efficiency, stability,and sustainable economic growth.

The Amendment Bill has been approved by the Mexican Senate and is now pending promulgation by the Mexican President before being published in the Official Gazette of the Federation. Once the amendments to the Securities Market Law and the Investment Funds Law become effective, the Mexican National Banking and Securities Commission (CNBV) will have a 365 days to make the required amendments to the secondary regulation.

The proposed amendments aim to create a new simplified procedure for the registration of securities in the RNV for small and medium-sized companies that comply with the requirements and characteristics set forth by the CNBV through secondary regulation. The simplified offering may only be purchased by institutional or qualified investors (such as Mexican pension funds) and shall not exceed the amounts set forth in the secondary regulation.

One of the main changes releases the CNBV from the obligation to review companies' filing and registration documents. Under the simplified registration regime, this review will be carried out by broker-dealers acting as underwriters, as well as by the selected securities exchanges.[4] The securities exchange will issue a favourable opinion once it establishes that the company complies with the requirements. Once the company receives a favourable opinion from the securities exchange, it can request registration from the RNV and deposit its stock certificates with the institution.

4 There are currently two securities exchanges in Mexico: the Mexican Securities Exchange and the Institutional Securities Exchange.

Companies currently maintaining securities registered with the RNV (listed companies) will not be allowed to participate in the simplified registration process. Therefore, they must follow the traditional authorisation process prior to the issuance of securities.

Listed companies can register securities with the RNV under the securities programme model. Under this model, listed companies qualify as recurring issuers with pre-authorised offering documentation, which eases the CNBV's authorisation process. However, the Amendment Bill expressly states that companies listed under the simplified registration regime may not register securities using pre-authorised documentation, so they would have to follow the authorisation procedure set forth for simplified issuers.

Likewise, the Amendment Bill states that only institutional investors may participate in offerings carried out by issuers within the simplified registration regime. This may present a disadvantage because institutional investors typically only invest in offerings of large companies that are already publicly listed and that have a track record and they may not wish to analyse or invest in small or medium-sized companies trying to access capital markets.

The CNBV will also be released from the obligation of supervising the periodic reporting of companies under the simplified regime; the securities exchanges will have the authority and obligation to set the rules for reporting to investors. Credit rating agencies will need to adopt specific valuation methods for securities issued under this regime.

Shareholders or investors of simplified issuers will have the right to report any simplified issuers' behaviour that may constitute a crime without the CNBV's input (as opposed to the process in place for traditional listed companies, which requires the CNBV to opine that the company has committed a securities crime).

The Amendment Bill also proposes the following amendments to the existing corporate regime of publicly listed companies:

- shares with differentiated rights may be issued without CNBV authorisation. Under the existing Securities Market Law, the CNBV must authorise the issuance of shares that are different to ordinary shares, provided that those differentiated shares do not exceed 25 per cent of the paid-in capital stock;
- shareholders' meetings may delegate to the board of directors the authority to increase the capital stock of the company and to set the terms for the subscription of shares;
- if shares are offered to institutional or qualified investors or to shareholders through a pre-emptive subscription right, there will be no need to prepare an offering memorandum or pre-register these in the RNV. It will only be necessary for the company to disclose the terms of the capital increase and

the subscription of the issued shares through the securities exchange in which the shares are listed. After this, the company may request a registration update from the RNV; and
- the prohibition on offering differentiated share packages to shareholders has been eliminated.

The Amendment Bill also proposes some changes to the corporate regime of investment promotion stock exchange corporations, including the elimination of the obligation to become a publicly listed company within 10 years of the registration of shares in the RNV or when their capital stock exceeds 200 million investment units.

Many companies have found that dual listing of their securities in two or more different securities exchanges is a desirable way to increase their share liquidity, their ability to access new capital and the trading of their shares for longer periods. The dual listing in US securities exchanges is a very attractive proposition for Latin American companies because of the depth of the equity capital market in the US.

A popular form of dual listing for non-US companies is through 'American depositary receipts' or 'American depositary shares'. Some companies that have taken advantage of this opportunity are Cemex, SAB de CV, America Móvil, Petróleo Brasileiro SA and Weg, SA, which are listed on the New York Stock Exchange.

Investors should be aware that non-US companies are subject to financial and other disclosure requirements that may differ from those required of US public companies. Additionally, investors need to do additional research on the political, economic and social conditions in the company's home country because those factors can affect the financial situation and results of the company and, consequently, the stock price.[5]

Hostile takeovers

Hostile takeovers are permitted under Mexican law but they are rare in Latin America in general because most public companies have either a controlling shareholder or a controlling group and there are very few listed companies or companies in which the controlling shareholder or controlling group is easily

5 Securities and Exchange Commission, Office of Investor Education and Advocacy, 'Investor Bulletin: American Depositary Receipts', www.sec.gov/investor/alerts/adr-bulletin.pdf.

identifiable. The number of companies that may not have defined control in Latin America is relatively low compared with other regions.

Article 48 of the Mexican Securities Market Law states that public companies may include clauses (known in developed M&A markets as 'poison pills') in their by-laws setting forth measures to prevent the acquisition of shares that will grant the control of the company by third parties or their shareholders (directly or indirectly), provided that these clauses:

1. are approved in an extraordinary shareholders' meeting with a favourable vote of at least 95 per cent of the capital stock represented in the meeting (the opposition to approval has to be less than 5 per cent);
2. do not exclude one or more shareholders other than the persons that are looking to obtain the control of the economic benefits that may arise from those clauses;
3. do not absolutely restrict a takeover of the company; if there are clauses that require approval of the board of directors, the criteria for the board to resolve these and the term for their resolution (maximum three months) must be clearly stated;
4. do not contravene the other provisions of the Mexican Securities Market Law for mandatory tender offers; or
5. do not may affect the exercise of the economic rights of the acquirer.

If a takeover clause does not comply with these requirements, it will be invalid.

The Amendment Bill also considers changes to the regime of takeover clauses, to facilitate their inclusion in companies' by-laws: first, the inclusion of a takeover clause must be approved in an extraordinary shareholders' meeting with a favourable vote of at least 80 per cent of the capital stock represented in the meeting (the opposition to the approval must be less than 20 per cent); and second, the requirements discussed in points (2) and (3), above, regarding the exclusion of shareholders and the restrictions must be eliminated.

Pursuant to the Mexican Securities Market Law, if a person or group of persons acquires, directly or indirectly, in one or several transactions, shares of a public company resulting in a shareholding of between 10 per cent and 29 per cent, they must inform the market through the corresponding securities exchange. If the intention is to acquire more than 30 per cent of the shares, directly or indirectly, in one or several transactions (either simultaneously or successive), they are required to carry out a tender offer on the following terms:

- the minimum term of the offer shall be 20 business days;
- the offering must cover all series of shares of the company, including shares with limited or without voting rights;

- the purchase price per share must be the same for all share types. The hostile purchaser cannot pay, deliver or grant any premium on the purchase price and must represent, under oath, in the corresponding offering memorandum, that there are no payments additional to the purchase price;
- the offer must indicate the maximum number of shares that it covers and, as applicable, the minimum number to which the tender offer is conditioned. If the acquisition of shares is equivalent to 100 per cent of the capital stock, pursuant to Mexican law the acquiring company must have at least two shareholders,[6] so must transfer at least one share to a different person or entity;
- the offering and its characteristics may be modified at any time before its conclusion, provided that the amendments give a more favourable treatment to the recipients or it is mentioned in the corresponding offering memorandum. If there are material amendments under the judgement of the CNBV, the offering must be extended by at least five additional business days; and
- the members of the board of directors and the relevant executives of the company must refrain from taking any action or making any transactions that would be detrimental to the company with the intention of hampering the development of the offering, from the moment they have knowledge of it until the end of the offering term. The members of the board must issue, within 10 business days of the tender offer being made (with the opinion of the corporate practices committee), their opinion regarding the offering's purchase price and the conflicts of interest that each director may have in connection with the offering.

In terms of Article 103 of the Mexican Securities Market Law, the person or group of persons that is required to carry out a tender offer but does not make an offer, or that obtains the control of a company against the provisions previously mentioned, will not be authorised to exercise the corporate rights that arise from the acquired shares, nor from the shares acquired after that moment. In this situation, the acquirer will be accountable before the other shareholder for all damages caused.

6 There is just one exception to this principle, applicable to a certain kind of company (simplified joint stock company), which cannot be a public company and is subject to certain special operating provisions.

Common anti-takeover defence clauses found in Mexican public company by-laws include:

- limitations to the participation of existing or future shareholders, with compulsory sales of the exceeding participation; and
- previous authorisation from the board of directors of the company for the transfer of shares or for carrying out tender offers, including the authority of the board to appoint buyers of the shares if the acquisition or transfer proposal is refused.

Notwithstanding this, in Latin America there have been few disputes concerning hostile takeovers of public companies. The results and judicial decisions made in those disputes become a relevant reference within the market in which they occur.

One of the best-known hostile takeover examples in Mexico involved the dispute between the controlling shareholder of Mexican airport operator Grupo Aeropuertario del Pacífico, SAB de CV (GAP) and railroad and mining company Grupo México, SAB de CV (GM) on the hostile takeover of GAP.

On 9 July 2010, GM announced that it had acquired 10 per cent of GAP's capital stock, stating that it was a treasury investment and that it had no intention of acquiring a significant influence in the company.[7] However, on 13 June 2011, GM, which at that time was holding approximately 20 per cent of GAP's outstanding shares, acquired through several purchases in the stock market,[8] announced its intention to acquire more than 30 per cent of GAP's shares.[9] Due to the provisions of the Mexican Securities Market Law, GM was required to carry out a tender offer for up to 100 per cent of the outstanding shares of the company. GAP and its controlling shareholder judicially opposed GM's tender offer.[10] According to GAP's 2011 Annual Report, by 25 January 2012, GM owned 28.7 per cent of its outstanding shares, acquired through several purchases in the stock market over a period of several months. On 29 March 2012, GM withdrew the tender offer for GAP's outstanding shares.[11]

7 Grupo México (GM) announcing its investment in Grupo Aeropuertario del Pacífico (GAP), www.gmexico.com/GMDocs/InformacionCNBV/Esp/INF_ES_2010_01.pdf.

8 GAP's 2010 Annual Report, www.aeropuertosgap.com.mx/images/inversionistas/pdf/Reporte_Anual_BMV_2010.pdf.

9 GM announcing its tender offer for GAP shares, www.gmexico.com/GMDocs/InformacionCNBV/Esp/INF_ES_2011_07.pdf.

10 GM announcing the actions filed by GAP and its controlling shareholder against the tender offer, www.gmexico.com/GMDocs/InformacionCNBV/Esp/INF_ES_2011_05.pdf.

11 GAP's 2011 Annual Report, www.aeropuertosgap.com.mx/images/inversionistas/pdf/infoanual11.pdf.

GAP's by-laws stated that no shareholder, either individually or jointly, could own more than 10 per cent of the capital stock of the company unless this limitation was modified in the by-laws. If a person, individually or jointly, acquired a percentage that exceeded the participation limit of 10 per cent it would be required to sell the exceeding percentage through a public offering; if this sale was not carried out, the shares representing the exceeding percentage would have no voting rights and could not be represented in a shareholders' meeting.

GM challenged GAP's by-laws in the Mexican courts,[12] stating that they contained provisions that contravened the Mexican Securities Market Law and that impeded its ability to acquire more than 10 per cent of GAP's capital stock and achieve the corresponding voting rights. After several years of litigation, in 2015 a Mexican court ruled that GAP's by-laws did not contravene Article 48 of the Mexican Securities Market Law, ratifying their validity and effectiveness and requiring GM to sell the percentage of shares that contravened the by-laws. GM filed a constitutional remedy against that resolution, arguing that Article 48 violated its economic freedom contained in Article 5 of the Mexican Constitution. This matter was resolved by the Mexican Supreme Court of Justice, which indicated that the Mexican Securities Law Article did not affect GM's economic freedom; on the contrary, it ruled that a company has the power to stipulate in its by-laws measures to prevent the acquisition of shares that might endanger the control of the company. The legal provisions condition the validity of the anti-takeover measures to comply with certain procedural and material requirements, established to protect minority rights, prevent discrimination against shareholders and prohibit absolute impediments for a takeover (that could even impede 'friendly' takeovers).[13] This resolution sets a non-binding court precedent that defines the viability of hostile takeover clauses in Mexico. During 2021, GM reduced its shareholding in GAP,[14] and in 2022 it sold all the shares it held in GAP.[15]

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12 GM announcing that it obtained a favourable resolution in the litigation challenging GAP's by-laws, www.gmexico.com/GMDocs/InformacionCNBV/Esp/INF_ES_2011_04.pdf; a few months later, GAP announced that it had appealed the resolution, www.aeropuertosgap.com.mx/files/eventos-relevantes/espanol/3_2_12_updateGAP_ESP.pdf.

13 First Chamber, Mexican Supreme Court of Justice, Thesis 1a.VIII/2022 (10a) with registration No. 2024256, March 2022, https://sjf2.scjn.gob.mx/detalle/tesis/2024256.

14 GM announcing the reduction of its shareholding in GAP, www.gmexico.com/GMDocs/InformacionCNBV/Esp/INF_ES_CNVB_Y_BMV_2021_22.pdf.

15 GM's 2022 Annual Report, www.gmexico.com/GMDocs/ReportesFinancieros/Esp/2022/RF_ES_2022_BMV.pdf.

Shareholder activism

Shareholder activism describes a series of activities or actions carried out by one or more of a publicly traded corporation's shareholders to result in a change in the corporation. It can be carried out through a wide range of actions, including meetings and dialogue with the management team to share or discuss proposals to be voted on in shareholders' meetings, proxy contests or media campaigns.[16] The concept is relatively new in Latin American corporate practice, unlike in the United States and Europe, primarily due to the existence of a controlling shareholder or a controlling group in public companies in the region. Over recent decades, institutional investors, such as pension funds and insurance companies, have increased their participation in companies in Latin America, becoming more active in companies' governance issues, financial performance and results.[17]

According to Professor Bernard Black, the level of shareholder activism is influenced by political as well as economic forces and it has generally involved two distinct approaches: presenting (or threatening to present) a shareholder proposal on a corporate governance issue, and 'jawboning' a particular firm's managers or board of directors to achieve a change in management or strategy.[18]

A positive aspect of shareholder activism is that it may help to improve a company's incorrect or wrongful practices that have been followed due to the instruction or mandate of the controlling shareholders, which may not benefit the company or its minority shareholders. Shareholder activists can implement strategies for the adoption of ESG principles that can transform the business of a company into a more sustainable one in the long-term.

On the other hand, there is also a negative aspect considering that certain shareholder activists may be more interested in short-term value creation, and they will tend to promote or support initiatives with that objective and be more focused in short-term earnings than on the creation of long-term value for the

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16 Cloyd, Mary Ann, 'Shareholder Activism: Who, What, When, and How?', in the *Harvard Law School Forum on Corporate Governance*, 7 April 2015, www.corpgov.law.harvard.edu/2015/04/07/shareholder-activism-who-what-when-and-how.

17 Pacheco, Hernan, 'Remarks on Shareholders Activism in Latin America', prepared for the international section meeting of the New York State Bar Association in Tokyo, Japan, November 2019, https://nysba.org/NYSBA/Sections/International/Seasonal%20Meetings/Tokyo%202019/Coursebook/Olof%20-%20REMARKS%20ON%20SHAREHOLDERS%20ACTIVISM%20IN%20LATIN%20AMERICA.pdf.

18 Black, Bernard S, 'Shareholder Activism and Corporate Governance in the United States', *The New Palgrave Dictionary of Economics and the Law* (1998), Vol. 3, pp. 459–465, https://ssrn.com/abstract=45100.

benefit of all shareholders. Lawyer Martin Lipton opines that 'boards need to guard against becoming increasingly risk averse and increasingly responsive to short-term pressures'.[19]

A common strategy of shareholder activists is to obtain control of the company, either by increasing shareholding or acquiring shares from other shareholders. By acquiring control, the activist shareholder will be entitled to exercise rights that it would not have with a minority participation in the company.

In Mexico, a shareholder activist or a group of activists can have several rights, depending on the shareholding that they represent. Shareholders that individually or jointly own 10 per cent of the capital stock have the following rights:

- to appoint or revoke a member of the board of directors in a shareholders' meeting;
- to request that the chair of the board or the auxiliary committees call a shareholders' meeting; and
- to request, one time only, an adjournment of the voting in a shareholders' meeting for up to three days, without the need for a new call, in any matter in which the shareholder or shareholders do not think they have been fully informed.

If a shareholder or group of shareholders owns at least 20 per cent of the capital stock of a company, they can judicially oppose the resolutions of a meeting in which they have a voting right.

For the exercise of liability actions against the members of the board of directors and executives of a public company, the shareholder or group of shareholders needs a shareholding of 5 per cent or more of the capital stock.

In Mexico, public companies can have certain control over, and must identify, the persons that hold a relevant shareholding because they have the obligation to submit a report (by June of each year) containing the full name of anyone that directly or indirectly owns 5 per cent or more of the capital stock of the company, as well as details of the 10 shareholders with the highest shareholding in the company, even if the participation does not represent 5 per cent of the capital stock. This is in addition to the disclosure obligations for the acquisition of shares discussed above.

19 Lipton, Martin, 'Some Thoughts for Boards of Directors in 2008', *AEI Legal Center – Briefly* (2008), Vol. 11, No. 7, https://ssrn.com/abstract=1090970.

Some practical measures that companies can adopt to minimise the risk of being targeted by activist shareholders include:

- clauses in their by-laws to prevent hostile takeovers;
- special quorums in their by-laws for the adoption of material decisions, either in a shareholders' or board of directors' meeting; and
- improvement in areas or activities that may be the main focus of shareholder activists, including submitting due and reliable financial information, carrying out timely and accurate disclosure of results or problems in the company, and attending to reasonable information or documentation requests.

The actions or requests of shareholder activists should not be considered as improvised actions and, therefore, be disdained. Most of these actions or requests are based on a meticulous analysis of the company's publicly available information (regarding how well the company is performing against its own goals and in relation to its competitors), as well as strategies previously planned by the activists.

Part IV

Select Topics Critical to Dealmaking

CHAPTER 11

Preliminary Legal Documents in Mexican 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 (MOUs), 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 MOUs, and from a practical perspective there are virtually no differences between these figures. We will refer to all these documents as 'term sheets' for the 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 these 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 item 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 in itself. Another frequently used alternative or additional level of protection is to establish specific conditions to which,

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

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 alternative 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 very 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 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 about 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, whether 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, including regulatory approvals;
- basic representations and warranties expected from the 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 edition, Wiley, 2011).

- exclusivity provisions that prevent the seller from engaging 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 for interpretation as possible, such as exclusivity, binding effects and jurisdiction, as these provisions may in fact determine the extent to which a court of law grants 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 the point at which the definitive agreements are engaged.

As mentioned above, the term sheet should clearly establish certain 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 that would be the 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 whether the preliminary documents would create binding obligations to consummate the deal or economic penalties to either party if they decided at a later stage against entering into definitive agreements or closing the deal.

There is a common misconception that preliminary documents are always non-binding in nature. Regardless of the title of the document, term sheets, letters of intent or MOUs 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 MOU is not enough to prevent it from being legally enforceable. If the 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 other things, the due diligence process, final negotiation, signing of definitive agreements and regulatory approvals.

A specific reference to which provisions, if any, are intended 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 the clauses that are binding and non-binding and will 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 for and obligations on 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 of 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 the 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 common to find stand-alone non-disclosure agreements (NDAs) alongside 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 in the absence of a stand-alone NDA. Also, confidentiality provisions and agreements tend to be more standardised within the market so it should be relatively straightforward and efficient for parties to be willing to be bound by their terms.

Owing to the fact that the harm caused by 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 the agreements or clauses to allow the parties to contain any leaks as quickly as possible through injunctions, without limiting their ability to claim compensation.

The definition of what constitutes 'confidential information' is highly negotiated. Counsel to the disclosing party will aim for a broad definition, generally covering, inter alia:

- any information disclosed by or on behalf of its client, in any form (whether written, oral or otherwise) and irrespective of whether the information was specifically marked as confidential;
- certain specific key elements, such as intellectual property, know-how, trade secrets, and customer and supplier lists;
- the existence of the negotiations and status thereof, and the existence and terms of any preliminary agreements (including the NDA); and
- any materials or notes prepared on the basis of or containing any 'confidential information'.

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 the information status of confidential information.

The term of the confidentiality duties is also a point of frequent discussion among parties. While the disclosing party often requests confidentiality to run indefinitely, a term of 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 this 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 these 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 comply with 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 the second stage, the parties should analyse the ways in which the 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 NDAs in place allowing them to disclose this information to their client only in a way that maintains the confidentiality of the sensitive aspects. 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 these employees if a transaction is not consummated, especially if the prospective buyer is a competitor. Common exceptions to these provisions include hiring as a result of an unsolicited request for employment by an employee or as a result of a general solicitation (including advertisement) that is not directed specifically at 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 directly into other preliminary agreements of the transaction, such as (depending on the structure of the transaction) the term sheet, letter of intent, MOU or NDA. In most cases, the exclusivity clauses and provisions included in the preliminary agreements are expressly made to be binding and are enforceable on the parties.

Through an exclusivity agreement or 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 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 clauses included in preliminary agreements to establish that, if the seller or 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 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 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 the 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 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 preliminary agreement that includes an exclusivity clause to establish the ability to extend the exclusivity period upon mutual agreement of the parties. Moreover, solid exclusivity agreements or clauses afford important benefits and are overly convenient from the perspective of the potential buyer due to the leverage afforded to the 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, they 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 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. Depending on leverage and jurisdiction, other liquidated damages in the form of a termination fee may also be discussed in certain circumstances.

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 and filing fees), 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 MOU.

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 into 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 the 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 the 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 the 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 and utility models, among other intangible assets.

Also, enterprises usually enter into 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 parties' contributions must be consistent with the proportionate share of all the expected benefits to be received by the transaction parties under the 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 agreement. However, one of the advantages of CSAs compared with variable royalty agreements such as joint ventures is that CSAs may provide taxpayers with unique opportunities to receive economic compensation from tax authorities that impose limitations on royalty payments. Another advantage is that the parties to a CSA contribute their own resources (whether human or 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 the exploitation.

These 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 this type of contract (the Guidelines).[4]

The purpose of the Guidelines is to, inter alia:

- ensure consistency in the valuation and pricing of assets and services, whether these assets and services are associated with a CSA;
- ensure a common framework in terms of the characteristics of the CSA, the risks involved in the transaction, the assets being transferred or the services being rendered; and
- detail the documentation requirements of the CSA.

Owing to their nature and characteristics, CSAs and cost-sharing clauses included in relevant agreements provide a competitive and advantageous mechanism for parties entering into M&A transactions as 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, parties to 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.

There has been 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.

4 'OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations 2022', https://read.oecd-ilibrary.org/taxation/oecd-transfer-pricing-guidelines-for-multinational-enterprises-and-tax-administrations-2022_0e655865-en.

Recent tax reforms

Recent tax reforms in Mexico, as in other countries in the region, have raised important issues affecting M&A transactions, increasing both analysis of tax risk and observation of related requirements. 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 the related tax risk, as well as how the risk, if any, is to be allocated among the parties. To emphasise this matter, the introduction of the General Anti-Avoidance Rule in 2020, by means of which the Mexican tax authorities may re-characterise 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 under 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, under which taxpayers or tax advisers are required to disclose certain specific schemes deemed potentially abusive, have also brought specific concerns to parties 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 that 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 making them 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 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.

Recent increase in M&A transactions

M&A activity in Mexico has recently grown considerably compared to previous years. One of the factors behind this is the nearshoring trend, which consists of moving manufacturing operations to a nearby country that offers greater cost-effectiveness.

Mexico's geographical proximity to the United States makes it strategic for manufacturing projects to export final products under very attractive conditions. The northern states of Mexico are the favoured destination for companies that aim to position their own operations closer to the United States, such is the case for Tesla's factory and the expansion of BMW, which are both located in the north of the country. In addition to strategic investors, private equity-sponsored acquisitions continue to constitute a sizeable proportion of total M&A activity, perhaps also fuelled in part by the nearshoring trend, while higher interest rates have not resulted in a significant reduction in deal volume.

Unlike in past years, we have recently seen a marked increase in Chinese manufacturers and strategic investors deciding to invest in Mexico.

Conclusion

Although it is possible to enter into an agreement without the existence of preliminary legal documents, the use of term sheets, letters of intent, MOUs (whether binding or non-binding), non-disclosure and confidentiality agreements, and exclusivity and cost-sharing agreements is crucial in Mexican M&A transactions, as they aid the negotiation process and provide protection to the potential transaction. A well-designed preliminary agreement can save months of negotiations and can help avoid the deterioration of relationships between parties.

CHAPTER 12

Indemnity Escrows and Other Payment Guarantees

Luis Burgueño, Alberto Córdoba and Elías Jalife[1]

Type of indemnity or payment guarantees

Indemnification is a contractual remedy and risk allocation mechanism typically used in M&A transactions to compensate a party for damages[2] suffered as a result of misrepresentations and breaches of warranties and covenants that become known or materialise after closing with respect to pre-closing facts, events and circumstances.[3] Indemnification provisions are usually heavily negotiated by the parties, on the one hand, allocating the risk related to the transaction and providing certainty as to which party will be liable for post-closing issues and, on the other hand, setting forth the terms, conditions and procedures under which the parties may seek indemnification under the applicable transaction agreement.

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2 The type of damages that can be indemnified is highly negotiated in M&A agreements. One point of frequent debate, with varying degrees and nuance depending on the applicable law of the agreement, is the inclusion or exclusion of indirect or consequential damages, '*lucro cesante*' or lost profits and opportunity costs, among others. Often, damages also include any third-party claims and attorneys' fees. Throughout this chapter, when we refer to 'damages' we include damages (*daños*) and losses (*perjuicios*), which, under Mexican law, are any loss or detriment suffered in net worth as a result of the breach of an obligation, and the deprivation of any legal gain that would have been obtained with the fulfilment of an obligation, respectively.

3 Parties to an M&A transaction may agree on including other 'special' indemnification items, as well as protection against certain types of damages that otherwise may not be protected, such as attorneys' fees.

In a traditional M&A transaction, the buyer as the likely indemnified party will negotiate for broad indemnification rights, while the seller as the likely indemnifying party will seek to limit the scope, term and amount of its indemnification obligations and may also try to limit the circumstances in which the indemnitee may bring a claim.[4] It is important to note that market conditions in certain countries may force some sellers towards a more buyer-friendly approach when negotiating indemnification provisions, aimed to getting deals done in a buyer's market, including in connection with distressed M&A transactions and unpredictable economic, political and business environments.[5]

A core aspect of indemnification provisions that requires significant negotiation from the parties is how the indemnity will be funded and payment thereof will be guaranteed. In practice, the mechanisms typically used for funding and securing an indemnity are the execution of an escrow agreement, set-offs against future payments, particularly earn-out payments, and a partial holdback of the purchase price.

Notwithstanding the foregoing, all personal and in rem guarantees legally available may be used as indemnification or payment guarantees in M&A transactions. The choice on the payment guarantees will often depend on various factors, including the specific characteristics of the transaction, the governing law, the purchase price of the transaction relative to the contingencies identified during due diligence, the ongoing and future relationship between seller and purchaser, etc. The agreed-upon indemnification provisions and the choice of the indemnity payment guarantees come down to the creditworthiness, credibility and payment capacity of the indemnifying parties factoring in the prospects of the indemnitor after closing.

In this chapter, we focus on describing the indemnification or payment guarantees more often used and available in M&A practice.

4 Limitations on the circumstances under which an indemnitee may bring a claim include monetary thresholds such as de minimis amounts, baskets and caps, as well as 'anti-sandbagging' provisions, which generally seek to prevent a party from bringing an indemnification claim for breaches of representations and warranties of which the party had actual or constructive knowledge prior to closing.

5 Fulvio Italiani and Giancarlo Carrazza, 'Distressed Mergers and Acquisitions: Lessons from the Venezuela Experience', in Paola Lozano and Daniel Hernández (eds), *The Guide to Mergers and Acquisitions* (Latin Lawyer, 2020).

Escrow and holdback

In M&A transactions, the indemnified party, typically the buyer, will often seek to secure payment of indemnification obligations of the indemnifying party, typically the seller, by setting aside or holding back an amount of cash (typically calculated as a percentage of the purchase price) until the expiry of the survival term of the indemnification obligations, thereby securing liquidity for any payment due. In cases where there are multiple sellers that are jointly and severally liable to buyer for indemnity and other post-closing obligations, the sellers may also prefer to set aside necessary funds in escrow, to reduce the risk of being held accountable for the inability of another seller to fulfil its obligations.

The main difference between an escrow and a holdback is that, in an escrow, the portion of the purchase price set aside is held by a third party (typically an escrow agent but it can also be a trustee or a financial depositary), while in a holdback the buyer or indemnified party directly retains or holds that portion of the purchase price. Naturally, the buyer or indemnified party will prefer a true holdback of the purchase price as it allows it to retain control of the funds, while the seller or indemnifying party will usually prefer the retained amount to be held by a third party, as this mechanism reduces the amount of control the indemnified party has over the funds and increases the likelihood that any funds remaining after payment of indemnification claims and expiry of the relevant term will be promptly released to the indemnifying party.

When agreeing on an escrow or holdback, parties should consider that the indemnifying party will often seek for this mechanism to be the only post-closing remedy for any indemnification claims and will try to limit the liability to the amount of the holdback or escrow amount, subject to customary exceptions, such as indemnity with respect to breach of fundamental representations or non-waivable rights in the case of fraud. In M&A practice, holdbacks are used far less often than escrows.

Furthermore, depending on the characteristics of the transaction, the parties may explore the possibility of maintaining a single holdback or escrow or separate holdbacks or escrows to secure payment of their indemnification obligations.

Escrow

In essence, an escrow is a segregated account that the parties to an M&A transaction often use for securing payment of their indemnification obligations, where the funds deposited in the account are held by a third party, whether an escrow agent, a trustee or a depositary. An indemnification escrow is typically funded by setting aside and depositing a portion of the cash payable as purchase price with a third party (whether into an escrow account, a trust or a security deposit).

Escrows are usually set forth as a contractual remedy in the main transaction agreements, securing payment of the parties' indemnification obligations, but also must be documented and effected in a separate agreement (ancillary to the acquisition agreement), such as an escrow agreement, a trust agreement or a security deposit agreement, as agreed upon by the parties, which will include the third party's rights and obligations in connection with its role of custodian of the funds. The choice of mechanism through which an escrow will be implemented in a given M&A transaction depends on several factors, such as the governing law, the domestic or cross-border nature of the transaction and the parties, and the leverage one of the parties may have over the other.

While escrow agreements are not prohibited by Mexican law, as is the case in most Latin American jurisdictions, they are not regulated and thus, when the transaction is subject to Mexican law, the escrow is usually implemented through the execution of a trust agreement or a security deposit.

Escrow agreement

An escrow agreement is the typical form of implementing an escrow in M&A transactions. While the escrow as such is not regulated under Mexican law and other jurisdictions in Latin America, there are other mechanisms with substantially similar effects, as we will further describe.

The parties to an M&A transaction may agree on the execution of an escrow agreement governed by US law and subject to a forum in the United States, when either the transaction documents are governed by US law and subject to a forum in the United States or one of the parties has enough leverage to insist on US law and forum for the escrow agreement. In this regard, it is very likely that the escrow agent will require that the governing law and forum of the escrow agreement be that of the jurisdiction in which the escrow agent is located, even if that governing law is different from the other transaction documents.

The escrow agreement with the escrow agent sets out the terms and conditions under which the escrow agent will hold and release the escrowed funds, in exchange for a fee. Escrow agents are usually banks or other financial institutions that often have their own standard forms of escrow agreements under which they provide their services and that set forth standard terms and conditions for these types of transactions. Although escrow agents are often open to negotiating the terms of their forms to accommodate some of the terms and conditions agreed by the parties, it is advisable to involve the escrow agent early on in the process to make sure that the terms negotiated by the parties are agreeable to the escrow agent.

Among the main terms and conditions of the escrow agreement often negotiated with the escrow agent are those regarding the distribution of funds or payments arising from indemnification claims and the rules applicable to the investment of escrowed funds. The parties will want to ensure that the escrow agent has a clear set of rules for the distribution of funds and the escrow agent will want to be released from any liability that may arise therefrom, for which the escrow agent will generally require either a joint written instruction by the parties, or a final decision of a court, arbitral panel or other third party with authority over the underlying issue, prior to releasing any funds in the escrow. For these purposes, the parties must agree on the applicable instructions, notices and other procedural rules for the release of funds, including upon expiry of the escrow period.

Additionally, the parties often have to consider if there will be a single or separate escrow accounts covering different risks. The latter may be used when there are various specified material, guaranteed obligations or when the escrow will also cover post-closing adjustments agreed under the transaction agreement. The indemnified party will often prefer one account to have more funds available to collect the applicable claims against the indemnifying party, regardless of the underlying indemnification event, while the indemnifying party will usually prefer separate escrow accounts to isolate exposure of the amount in escrow and provide for separate escrow release dates. These considerations by the parties may also arise depending on the agreement of different release dates of the applicable indemnification obligations or other obligations guaranteed by the escrowed funds.

In transactions where the purchase price is represented by stock or a note, it is not uncommon for the parties to place the stock or notes in escrow to guarantee their indemnification obligations. In these cases, aside from the fact that the parties should pay particular attention to the applicable securities and tax provisions, they should also agree to and set forth the terms and conditions applicable for the valuation and transfer of the stock held in escrow upon an indemnity claim.

Moreover, in transactions where the parties choose to place assets other than money (such as real estate) in escrow to secure the payment of indemnity obligations, it is convenient to include provisions in the transaction documents, to determine the manner in which the relevant escrowed assets will be valuated should an indemnification event occur, and the applicable process in which the assets will be sold if necessary. Consequently, the parties must take into consideration all the legal formalities required to transfer the escrowed assets to the escrow agent under the applicable law.

Selecting the escrow agent

When choosing the escrow agent or a trustee or depositary, the parties might consider whether any of them has an existing or strong relationship with the agent to address potential conflicts of interest but also so that they are in a position to negotiate better fees and terms under the escrow agreement (or the applicable guarantee trust or security deposit agreements). Both parties look for a reliable independent party so that it will not be prejudiced towards or against any of them in following the agreed upon rules and procedures, especially regarding release of funds to any of them.

The parties should identify who the escrow agent will be as soon as possible, to be able to negotiate the escrow agreement in good time, as well as to agree on the way the agent's fees will be paid between the parties. Although the parties may negotiate the payment of the escrow agent's fees, it is very common for the escrow agent's fees to be split between the indemnifying party or seller and the indemnified party or buyer. Furthermore, it will give the parties time to determine the rules applicable to the investment of the funds in escrow (or guarantee trust or security deposit).

Escrow amount and term

In M&A transactions, when determining the amount of the escrow (or amount transferred into a guarantee trust or security deposit), the indemnified party will usually try to ensure that the amount is high enough to cover all possible indemnity claims and that the term is equal to the survival period for non-fundamental representations and warranties agreed upon in the transaction agreement, which typically may range from six months to as long as three years (most commonly between 12 and 18 months).

The indemnified party may also take into consideration the effort that may be required to bring an indemnity claim and collect payment thereof, as well as the creditworthiness of the indemnifying party. On the other hand, the indemnifying parties will try to keep the escrow amount and period as small and short as possible.

In M&A transactions, it is common practice for the escrow amount to be agreed upon as a percentage of the transaction value or purchase price; however, this percentage may significantly vary between transactions, typically around 7 per cent to 20 per cent depending on the nature and size of the deal, and the depth and results of due diligence. Escrow amounts lower than 10 per cent of the purchase price are typically limited to larger deals or in cases where the escrow is not the exclusive remedy available to the indemnified party or buyer, as other guarantees or insurance may be in place to guarantee payment of indemnity claims or other obligations of the parties under the transaction agreement.

Parties to M&A transactions often agree to post-closing price adjustment provisions, typically for differences in working capital or net debt from enterprise value determination at closing, but also to accommodate certain factors that can only be determined post-closing (e.g., inventories, number of subscribers or antitrust mandated divestitures), as a result of which the purchaser may be entitled to a post-closing reimbursement of a portion of the purchase price paid at closing or be required to make an additional payment. In these cases, it is convenient for the parties to determine whether the escrow or other security or guarantee arrangement will also secure the seller's reimbursement obligation resulting from the price adjustment and, if applicable, the procedure to be followed to apply the funds held in escrow to the payment of the reimbursement. As a general rule, however, a purchaser will be advised to ensure that the escrow or other security established to secure the eventual payment of indemnification obligations is not applied to the seller's reimbursement obligation arising from post-closing price adjustments, to prevent its indemnification guarantee from being eroded.

It is also common practice to structure the escrow in tranches that guarantee specific indemnification obligations for contingencies identified during due diligence (for instance, tax claims or pending litigation), with their own set of terms and conditions, and release dates.

Interest accrual beneficiary

In M&A transactions, the determination of which party, whether the indemnified or the indemnifying party, is entitled to receive any accrued interest generated by an indemnity guaranteed amount, if any, is especially important in guarantees in which the guaranteed amount is transferred to another entity and administrated so that it generates interest, as is the case of an escrow, a guarantee trust or a security deposit.

In a holdback whereby the buyer or indemnified party retains a portion of the purchase price, although it may be negotiated otherwise, typically the buyer is required to hold the funds in a separate account and any accrued interest will be for the benefit of the indemnifying party.

When the payment guarantee is being held in escrow, the indemnifying party is typically the one entitled to receive the accrued interest generated by the guaranteed amount. However, the parties often negotiate whether accrued interest should be distributed to the indemnifying party or should be part of the escrowed funds that may be used to secure the covered obligations. The parties may also agree for the escrow agent to make investments under a specific set of rules. Although there is no rule of thumb, the indemnified party is usually more concerned than the indemnifying party with maintaining very conservative investment guidelines, providing for liquid investments that make it easy for the escrowed funds to be available as needed.

Release notices and conditions

In M&A transactions, release of the indemnification payment guarantees are typically subject or linked to the survival term of the indemnification obligations. The general rule is that both the payment guarantees and the indemnification obligations of the parties are released and expire, respectively, by the sole passage of time. However, the escrow terms and conditions typically provide for the extension of the release term if an indemnification claim is filed before the expiry of the release term, for the indemnified party to bring its claim to court or arbitration and, once started, until the dispute is settled.

In any case, it is advisable for the parties to an M&A transaction to agree on clear release mechanisms of the escrowed funds. These mechanisms include setting forth the procedure applicable to indemnity claims, including notices from the indemnified party to the indemnifying party upon the occurrence of any misrepresentation or breach of warranty or covenant from the indemnifying party, periods for the indemnifying party to cure any misrepresentation or breach of warranty or covenant, as well as the resolution mechanism applicable in the event of controversy on an indemnity claim (arbitration is typically used in M&A deals in Latin America).

Also, it is key to agree on clear and unequivocal release conditions or triggers. These may consist of notices to the applicable agent, which may be agreed to be given jointly by the parties upon settlement of an indemnification claim, or even from a third party such as a third-party law firm confirming that the applicable conditions for releasing the funds have been met, or if a party provides a final and non-appealable judgment by a competent court or tribunal requiring payment of the relevant sum to the indemnified party. Escrow agents typically prefer joint written instructions by the parties, as they do not want to be caught up in disputes among the parties (e.g., in connection with the calculation of interest payable in accordance with a court order).

In addition to the agreed release conditions, the parties may consider different or staggered release dates of the escrowed funds, which are typically preferred and negotiated by the indemnifying party or seller, while the indemnified party or buyer will prefer to maintain the escrowed funds for the longest possible period of time. This is more often agreed when the agreed upon escrow term or amount is high compared to market standards, when other obligations or adjustments are covered by the escrowed funds or when the indemnification obligations have different survival terms, in which case a portion of the escrowed amount may be released following the applicable adjustments or calculations, and the remaining amount may be released after the expiry of the applicable indemnification term.

Guarantee trust

When the parties to an M&A transaction agree on securing their indemnification obligations under Mexican law, an often-used vehicle is a guarantee trust. Under a guarantee trust agreement, the indemnifying party transfers an amount of money (typically a portion of the purchase price) to a trustee, which maintains legal title to the funds and provides its services in exchange for certain fees, until the expiry of the survival term of the relevant party's indemnification obligations under the transaction agreements.

Under Mexican law, only financial institutions such as banks and other authorised legal entities such as SOFOMs (multiple-purpose financial companies) are authorised to act as trustees in guarantee trusts. There are specific rules applicable to this form of trust, and trustees typically have their own standard forms of guarantee trust agreements under which they provide their services and which set forth standard terms and conditions for these types of transactions.

Similar to provisions available under escrow agreements, under a guarantee trust, the parties may agree on specific rules for distribution of funds or payments arising from indemnification claims, the establishment of the amount of the guarantee trust and the authorised investments of the transferred funds.

Security deposit

Another legally available mechanism commonly used in Mexico to secure payment of indemnification obligations in M&A transactions is a security deposit. A security deposit is an agreement under which the indemnifying party transfers possession of funds (again, typically a portion of the purchase price) to a third-party depositary. The depositary acts solely as such (unlike the trustee to which legal title over the funds is transferred) and has the obligation to maintain the funds and any proceeds or interest accrued therefrom.

Depositaries are usually financial institutions authorised as such under Mexican laws and regulations that provide their services in exchange for a fee. As in the escrow and guarantee trust agreements, the depositaries often have standard security deposit agreements for those types of transactions. However, the parties may negotiate certain terms and conditions to abide by the provisions of the transaction agreements.

Bankruptcy remoteness

Which of the previously mentioned mechanisms is chosen depends on the nature of a particular transaction. The parties have to consider several factors, such as the applicable fees for each mechanism (guarantee trust or security deposit) and even the particular regulation that would apply in the absence of a specific agreement on a particular subject. In particular, counsel to the party in which favour the security is established must carefully analyse how the bankruptcy or insolvency laws apply to the selected mechanism to ensure that the security arrangement is effectively bankruptcy remote. As a general rule, security arrangements where the collateral remains in the possession of the potential indemnitor are less bankruptcy remote because even if the applicable insolvency laws recognise the preferred status and ranking of secured creditors, separating the collateral from the bankruptcy proceeding may be time-consuming and costly, in some cases to the extent that it significantly diminishes the value of the collateral. Security arrangements where the collateral is in possession of the creditor (e.g., pledge) provide better protection to the secured indemnitee. Ultimately, security arrangements where not only possession but also title is transferred to the potential indemnitee or a third party are most effectively bankruptcy remote, as is the case for trust agreements, where title, and not only possession, of the collateral is transferred to the trustee and the trustee can retain possession and proceed to the sale of the collateral and use of the proceeds to pay the indemnitee, irrespective of the bankruptcy proceeding.

Holdback and set-off rights

Parties to M&A transactions, and specifically the buyer, may seek to secure payment of their counterparty's indemnification obligations by holding back a portion of the purchase price until the expiry of the survival term of the indemnifying party's indemnification obligations.

On the other hand, when an M&A transaction provides for one or more post-closing payments that are contingent on the satisfaction of certain milestones related to future performance, the indemnified party may seek to secure payment of the indemnifying party's indemnification obligations by including a set-off covenant in the applicable transaction agreement.

Holdback of the price by the purchasing party

If a holdback of a portion of the purchase price by the purchasing party is agreed as guarantee of the indemnifying party's indemnification obligations, the indemnified party will directly hold or retain that amount until the expiry of the survival term of the indemnification obligations or shorter period agreed upon. If, upon expiry of the applicable term, no indemnity claim and payments are due or pending, the indemnified party is required to deliver the holdback amount to the seller or target.

Holdbacks are not commonly used as guarantee payments as they give full control of the holdback amount to the indemnified party. Thus, holdbacks are agreed upon when the buyer or indemnified party has substantial leverage over the seller or indemnifying party or when there is a broader long-term business relationship between the parties to the transaction. Usually the seller or indemnifying party will prefer that the funds are held by an independent third party.

The parties may also agree that a holdback covers both working capital adjustments or other price adjustments and indemnification claims. Under this scenario, it is common to agree to the release of a portion of the holdback amount following the final working capital calculation or price adjustments, with the remaining holdback amount to be released after the expiry of the indemnification survival term.

Set-off right against earn-out and other future payments

The parties to an M&A transaction may agree on one or more payments to be made by the purchaser to the seller or indemnifying party after closing, should the target company achieve certain previously defined financial goals or milestones. These payments are known as earn-out payments and are usually stated as a percentage of gross sales or earnings or other financial metric. The main purpose of an earn-out is to allocate the future risks and rewards of a target company, whereby the parties share both the success and the risk of the outcome of the target company during the earn-out period.

Therefore, if the purchase price of an M&A transaction includes certain future or milestone payments or earn-out payments, usually to be paid to the selling or indemnifying party, the parties to the transaction may consider using a set-off mechanism for securing and funding indemnification obligations. Under this mechanism, the parties may agree on certain provisions in the transaction agreement for the purchasing party to withhold the pending milestones or earn-out payments to which the seller or indemnifying party is entitled as guarantee payment of its indemnification obligations if indemnity claims and payments derived therefrom arise and are due to the indemnified party after the closing of the transaction.

Strictly speaking, a set-off is the reduction of future payments in the amount owed to the indemnified party under the indemnifying party's indemnification obligations. This mechanism may be a good incentive for the indemnifying party to perform as intended; however, the downside is precisely the fact that future payments are often conditional or uncertain to occur. If the target company fails to meet the specified milestones within the agreed periods, the buyer will be released from paying the applicable payment or earn-out to the seller.

Under this mechanism, the buyer or indemnified party will seek to have the right to withhold and offset contingent payments that have materialised for the benefit of the seller, against amounts owed by the seller to the buyer in connection with indemnification claims. In the end, the agreed-upon provision will often depend on the leverage the indemnified party may have over the indemnifying party. Usually, the parties agree on the specific provisions applicable for exercising a withholding and offset right, such as the requirements applicable thereto, notices and dispute resolution mechanisms between the parties. When the parties do not agree on the applicable mechanisms for exercising and settling disputes on these matters, it may be more complicated in practice as they would have to raise claims before the competent courts and payment derived therefrom may only be collected upon a final and non-appealable judgment.

Other in rem guarantees

In some cases, the parties' indemnification obligations can be secured by assets different from cash, often related but not within the scope of the transaction. The buyer will seek that the assets used to secure the indemnity payments are of greater value (whether collectively or individually) than the estimate of the indemnification amount agreed by the parties. Assets that have an active trading market (such as equity of publicly traded companies) are also preferable. Assets that may provide immediate liquidity like real estate or privately held shares with dividend rights are also appealing. Assets used as guarantee can be owned by the indemnifying party or by a third party (usually related to the indemnifying party). However, involving a third party will necessarily increase the complexity of the negotiations and the execution.

In the event of an indemnity claim, the indemnified party would be entitled to receive payment thereof whether by acquiring title to the collateral or by the amount derived from the execution and sale of the assets, as agreed by the parties.

There are two main types of in rem guarantees, depending on whether the collateral is real estate or personal property, available to parties to an M&A transaction for securing their indemnification obligations: mortgages over real estate and pledges over stock or other personal property. These guarantees are typically required to be granted before notary public and registered before public registries to be valid and perfected, that is, enforceable on third parties.

Although these guarantees are available for parties to an M&A transaction to secure indemnification obligations, they are not commonly used in practice. For further information on these guarantees, see this chapter in the first edition of this guide.

Personal guarantees

Parties to an M&A transaction may agree that their payment indemnification obligations are guaranteed by a third party, which may or not be related to the parties to the transaction. In these types of guarantees, the person or entity that issues the guarantee undertakes the indemnifying party's payment obligation either directly or in case of default by the indemnifying party, and, as a result thereof, the indemnified party has a direct action against the third party granting the guarantee to collect payment derived from an indemnity claim.

Parent guarantees and other personal guarantees granted by related parties

In practice, guarantees granted by related parties to an M&A transaction are usually an alternative when the seller is a holding or special purpose vehicle or is otherwise not an operating company with sufficient creditworthiness and thus the parent company or another affiliate has to guarantee the seller's obligations. In contrast, these guarantees are typically not required when the indemnifying parties are stand-alone companies or entities with a substantial balance sheet and operations of their own. These payment guarantees can be:

- parent guarantees, granted by a parent or an affiliate company of the indemnifying party to secure any indemnity payment obligation of the indemnifying party and often implemented through the inclusion of a specific guarantee clause in the transaction agreement or the execution of a separate surety agreement setting forth the guaranteed obligations, customary waivers to guarantor's legal protections, limitations of guarantor's liability and other terms and conditions of guarantor's obligations; and

- joint and several liability of multiple sellers or of a parent company or other affiliate, used when there is more than one indemnifying party and all parties guarantee all of their obligations under the transaction agreement, including their indemnification obligations, as joint and several obligors.

For further information on these guarantees, see the first edition of this guide.

Personal guarantees granted by third parties

Exceptionally, indemnification obligations may be guaranteed by third-party financial institutions, either through a standby letter of credit or a surety bond. Although these guarantees are available for parties to an M&A transaction to secure indemnification obligations, they are not commonly used in practice. For further information on these guarantees, see the first edition of this guide.

Standby letter of credit

A standby letter of credit is an instrument whereby a financial institution, acting upon the request and instructions of a client, irrevocably agrees to pay certain amount of money to a third party upon demand and delivery of certain documents. As the letter of credit constitutes a direct obligation of the financial institution, from the indemnified party's perspective the credit risk is shifted from the indemnifying party to the financial institution, which is very favourable to the indemnified party, though usually expensive.

In M&A transactions, the standby letter of credit can be a mechanism for securing the parties indemnification obligations, for which the indemnifying party must obtain a standby letter of credit from a financial institution naming the indemnified party as beneficiary, and the indemnified party is entitled to obtain payment for any damages derived from an indemnification claim directly from the financial institution issuing the standby letter of credit. Standby letters of credit used in M&A transactions are commonly subject to rules issued by the International Chamber of Commerce, such as the ISP98 (International Standby Practices published in 1998) or the UCP 600 (Uniform Customs & Practice for Documentary Credits published in 2007).

This mechanism is often used in M&A transactions when the indemnifying party either (1) previously provides the applicable funds to the financial institution for the issuance of the standby letter of credit; or (2) has an existing line of credit with the financial institution and the standby letter of credit used to secure its indemnity obligations is the means to dispose of that credit. In both cases, the standby letter of credit is irrevocable.

The standby letter of credit may be convenient for the indemnified party as it is easily enforceable and the risk of insolvency of a financial institution is typically low, especially relative to the indemnifying party's; however, the letter of credit may entail a big financial burden to the indemnifying party as it will have to obtain (or use an existing) credit facility with the financial institution and in some cases grant collateral to secure its obligations before that institution and assume restrictive covenants during the term of the credit facility.

Surety bond

Another useful indemnity guarantee granted by a third party is the surety bond. To guarantee an indemnity payment through a surety bond, the indemnifying party has to contract with a surety institution, which agrees to pay the party's indemnity payment obligation in case the indemnifying party fails to do so.

The surety bond is typically implemented through the execution of a surety agreement or surety line. It is possible for the parties of a surety agreement to determine the scope of the surety bond; by default, the surety institution has order and excuse benefits in granting a surety bond. Therefore, due to the order benefit, the surety institution is liable before the indemnified party only if the indemnifying party has failed to make the respective payment. Likewise, the surety institution has the excuse benefit, through which it can appoint some or all the indemnifying party's assets to pay for the indemnity amount if that amount is requested from the surety institution by the indemnified party. Both the order and the excuse benefits can be, and in practice are normally, waived by the surety institution, which would be more convenient to the indemnified party, since it would have higher collection possibilities against the surety institution.

The surety institution collects a fee, typically calculated as a percentage of the contingent amount, in connection with the secured amount and has recourse against the indemnifying party if the institution has to pay some or all of the indemnity claim. In practice, the surety institution usually requires the indemnifying party to prove its solvency so that the surety institution can validate its creditworthiness. The surety institution may even require the contracting party to guarantee the payment of the secured obligations by some other means (for example, a mortgage).

Promissory note

Although not very commonly used, it is also useful for the parties of a transaction to secure the payment of their indemnity obligations through the execution and delivery of one or more promissory notes. The promissory note is a negotiable instrument that constitutes an unconditional promise of payment made by the indemnifying party should that indemnifying party be bound to pay any indemnity claim to the indemnified party. Promissory notes may be convenient because of their nature as negotiable instruments, which means that, in practice, they can usually be enforced in special judicial procedures that are often faster and give greater collection rights to the indemnified party than other mechanisms, such as the possibility of embargoing assets from the indemnifying party at the beginning of the judicial proceeding. However, a promissory note does not provide security over specified assets and, therefore, it does not solve potential lack of creditworthiness and insolvency of the indemnifying party.

CHAPTER 13

Regulatory and Corporate Approvals and Interim Covenants in Latin American Deals

Juan Bonet, Eduardo Patricio Bonis, Ricardo Güell and José Francisco Iturrizaga[1]

Introduction

Latin America is a thriving territory for M&A deals. In 2022, despite the uncertainty, instability and volatility of the past couple of years, mainly due to the global economic crisis and the covid-19 pandemic, there were 3,452 M&A deals with a total (declared) value of US$97.9 billion.[2] Moreover, the 2021 edition of the cross-organisational 'Venture Capital & Private Equity Country Attractiveness Index' positions key jurisdictions in the Latin American market such as Mexico, Chile, Brazil and Colombia in its list of the best 50 countries to invest in globally.[3]

M&A transactions in Latin America are usually structured following US practice, entailing an acquisition agreement with a two-step procedure with a signing and closing date. The parties carefully regulate the transitional period between signing and closing, mostly in terms of the conduct of the seller. There are multiple reasons for having an interim period in certain circumstances. For example, certain M&A transactions may be subject to regulatory approval from

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2 See 'The LatAm M&A landscape: Gradual rise in deals on the horizon', Bnamericas, 30 March 2023, www.bnamericas.com/en/interviews/the-latam-ma-landscape-gradual-rise-in-deals-on-the-horizon.

3 See, 'Venture Capital & Private Equity Country Attractiveness Index', 2021 edition (IESE Business School, eXapital), https://blog.iese.edu/vcpeindex/ranking/.

various governmental agencies. As the global economy becomes increasingly interconnected, businesses seeking to expand their footprint in Latin America must navigate a complex web of regulatory and corporate approvals. While these approvals ensure the protection of local interests and maintain market integrity, they can pose significant challenges to potential investors and merging entities.

The transaction may also be subject to third-party consent (i.e., from a lender or commercial key partner). In some cases, there is a condition to closing for sellers to modify the group's corporate structure or undertake other corporate reorganisation before the equity investment may be received.

Robust clauses covering the interim period from execution to closing prevent non-desirable scenarios for buyers while also bringing certainty to sellers. Additionally, strong and solid drafting clauses prevent the seller from jeopardising the economics of the target company in the relevant period before closing.

This chapter reviews the regulatory and corporate approvals needed for closing M&A transactions in Argentina, Peru, Costa Rica and Uruguay. It sheds light on the regulatory frameworks governing these transactions and provides key insights for negotiating the most common interim covenants in these countries. It also emphasises the importance of understanding local nuances and cultural considerations.

Even though local applicable laws of the above-mentioned countries are discussed, the chapter applies to the entire region, as the challenges posed by M&A transactions are similar within all Latin American countries. As the M&A landscape in these countries continues to evolve, staying abreast of the latest regulatory changes and best practices is paramount. Whether readers are seasoned investors or companies looking to establish a foothold in the Latin American market, this chapter aims to provide an overview of the key issues and considerations to keep in mind with respect to the interim period.

Regulatory and corporate approvals

When dealing with M&A transactions in the region, investors and potential buyers are often required to deal with a challenging regulatory landscape. Consequently, preparation in this regard is essential. In recent years, contrary to the liberal political landscape seen in the 1990s, increased protectionism has led to a more regulated environment from several standpoints.

Hence, good practice before entering into an M&A transaction in the region is to carefully scrutinise the regulatory requirements that will need to be followed not only in terms of the transaction but also in relation to the investment vehicle to be used as well as the requirements regarding the flow of the investment and the possibilities and mechanisms for repatriating funds due to the current regulations on foreign exchange controls.

Antitrust authorisation

Several countries across the region have bolstered their antitrust law regimes in recent years. For example, in Argentina, Law No. 27,442 (the Argentine Antitrust Law (AATL)), which entered into effect on 24 May 2018, replaced the former antitrust law.[4] The AATL created the Argentine Competition Authority (ACA), which is composed of the Antitrust Tribunal, the Secretariat of Anticompetitive Behaviours and the Secretariat of Economic Concentrations.

The main difference between the AATL and the former antitrust law is that the AATL provides for an *ex ante* control regime for economic concentrations as opposed to the post-closing merger notification system provided for in the former law (i.e., parties to a transaction must now file within one week prior to the deal closing). However, because the ACA has not yet been created, the post-closing notification regime still applies.

Uruguay, which traditionally did not regulate pre-merger control for antitrust purposes, has gone down a similar path. Following amendments to its Antitrust Law in 2020,[5] parties whose gross income within the Uruguayan territory totals at least US$90 million in the three fiscal years prior to the proposed merger require pre-merger authorisation. If parties fail to comply with this approval request, the transaction shall be deemed null and void (or not entered into, depending on certain civil law technicalities).

Since June 2021, Peru has had a regime for the control of corporate mergers, the purpose of which is to promote effective competition and economic efficiency in the markets for the welfare of consumers. The regulatory framework of Peru's merger control regime is under the supervision of the National Institute for the Defence of Competition and Intellectual Property (INDECOPI). Certain transactions are subject to prior review by INDECOPI, such as:

- acts that qualify as a business concentration, or any act or operation that implies a transfer or change in the control of a company or part of it;

4 Law No. 25,156.
5 Law No. 18,159.

- acts of business concentration that produce effects in all or part of the national territory; and
- operations that meet the established thresholds in Law No. 31,112 and its regulations, approved by Supreme Decree No. 039-2021-PCM.[6]

Costa Rica's Competition Promotion Commission has been the main governing body for merger control since its creation, especially since pre-merger authorisation was implemented in 2013, pursuant to a modification to the law in 2012. Under an additional modification in 2019, the Telecommunications Superintendence was appointed as the merger control body for the telecommunications sector.

To sum up, many Latin American countries have progressively strengthened competition law to prevent antitrust practices and ensure a level playing field for all market participants. Obtaining antitrust clearance is a pivotal step in the M&A process, as closing certainty will be heavily impacted by, if not fully dependent on, obtaining clearance. Regulatory bodies rigorously assess the potential impact of a merger or acquisition on market dynamics. Companies must be prepared to provide detailed information about their operations, market share and possible competitive effects of the transaction. Depending on the jurisdiction involved, failing to secure antitrust approval can lead to significant legal repercussions, financial penalties and even the unwinding of the transaction. Understanding and navigating the antitrust authorisation process is essential for any successful M&A endeavour.

Other regulatory approvals

In addition to antitrust regulations, M&A transactions may also be subject to other governmental approval or compliance with mandatory filings, ranging from mere notification to mandatory prior approval or waiting period, depending on the type of industry, activity or transaction involved. When facing an M&A deal subject to prior approval from a governmental agency, it is essential that the target company, as well as both seller and buyer in some circumstances, gathers and provides the relevant corporate, financial and legal information to obtain authorisation. For this purpose, parties should be aware of their role in these requests, and this should be clearly stated within the share purchase agreement (SPA) as this often generates tension among the parties.

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6 See 'Doing Business in Peru: Overview', https://uk.practicallaw.thomsonreuters.com/0-500-7812?transitionType=Default&contextData=(sc.Default)&firstPage=true#co_anchor_a887955.

For example, in Peru, financial companies are required to apply for authorisation for a change of control from the regulatory body, the Superintendency of Banking, Insurance and Pension Fund Administrators. Requests for approval also apply in Costa Rica, as regulators must approve control changes in regulated industries. Additionally, complete ownership chains up to the final beneficiary, and any changes of control therein, must be reported to the Final Beneficiaries Registry. In Uruguay, entities operating under any licences issued by the Central Bank of Uruguay (i.e., banks, brokers, dealers, financial advisers, and insurance and pension fund management companies) require prior authorisation to transfer their shares. Finally, regarding consent for the transfer of shares in the Argentine financial industry, parties need the approval of the Argentine Central Bank when dealing with financial institutions and the consent of the Superintendence of Insurance when dealing with insurance and reinsurance companies or their mergers and spin-offs.

The financial sector is a prime example of an industry in which authorisation is required in the M&A sphere. Other key industries protected by the government also impose authorisation or notification requirements. Parties in the telecoms, health, and oil and gas industries must receive the green light from the appropriate watchdog prior to transferring shares.

Corporate reorganisation

Aside from governmental approval or third-party consent, a corporate restructuring of the target company may be required between signing and closing (e.g., to carve-out or transfer in certain assets). In Latin America, there are a variety of legal procedures for a company's reorganisation:

- mergers (two or more companies combine to create a new independent company or one company absorbs the entire business of the other company, whereby the target company ceases to exist);
- simple reorganisations (assets and liabilities or business lines are segregated and transferred to a subsidiary or related company);
- spin-offs (assets and liabilities or business lines are segregated and transferred to another company or used to create a new company, or the company is completely split and spun-off to create two or more new companies); and
- transformation (the transformation of one company into another form of company or even into another kind of legal entity).

Some jurisdictions, such as Costa Rica and Panama, also allow for international or cross-border mergers or companies transferring to another country.

As the region's start-up ecosystem matures, it is worth sharing some thoughts about corporate reorganisation in this area. Whenever a Latin American company considers bringing international investors into the company, the conversation about a corporate flip to an international corporate structure arises. Corporate flip is the process by which start-up founders transfer shares from the local subsidiaries to holding companies above the operating company to receive investment from seed and venture capital investors. Under this framework, the most common legal structures for start-ups in the region are the 'Cayman sandwich' (whereby the founders incorporate a Cayman holding company that wholly owns a Delaware LLC, which fully owns the local subsidiaries) or a 'Delaware toast' (whereby the founders transfer the shares of the local subsidiaries of a Delaware LLC to local subsidiaries). The potential investor then acquires shares from the Cayman holding company or the Delaware LLC, depending on the structure used.

Before adopting this strategy, a detailed analysis of the corporate structure, as well as the respective tax impacts, according to the conditions of the founders and the reality of the Latin American subsidiary should be carried out.

Interim covenants

A covenant is an agreement, convention or promise entered by two or more parties in a written, signed and delivered instrument under which one of the parties undertakes to the other to do or not to do something or to affirm the veracity of certain facts.

Hence, affirmative and negative covenants are translated into commitments to do something or to refrain from doing something in the interim period from signing to closing. Failure to comply with these may enable the non-breaching party to demand specific performance or, upon material breach, to refrain from closing the deal and, in some cases, to claim damages from the breaching party.

Interim covenants play a pivotal role, acting as the connective tissue between the signing of an agreement and its eventual closing. These covenants serve multiple purposes, ensuring that both parties maintain the status quo and preserving the value and integrity of the transaction during the transitional phase, as well as regulating efforts and actions that need to be taken to reach closing.

At their core, interim covenants are designed to protect the interests of both the buyer and the seller. For the buyer, they offer reassurances that the business will continue to operate as usual, without any significant changes that might adversely affect its value or operations. For the seller, these covenants can provide guarantees against potential liabilities and ensure that the buyer remains committed to the transaction.

However, crafting effective interim covenants requires a delicate balance. They must be stringent enough to offer the necessary protections, yet flexible enough to allow for the regular course of business operations. Overly restrictive covenants can stifle a company's ability to adapt to market changes, while overly lenient ones may expose the other party to undue risks.

Affirmative and negative covenants

Affirmative covenants are those in which one party binds itself to the existence of facts or to the future performance of a certain act, while negative covenants are those in which the grantor of the covenant undertakes not to perform a certain act. The most common interim covenants include:

- the covenant to operate the target in the ordinary course of business and to obtain the buyer's consent for specific business matters;
- the covenant to undertake certain actions or efforts to reach closing, including obtaining governmental filings, authorisations or permits; and
- the covenant to maintain confidentiality and to refrain from making public announcements, among other things.

Ordinary course of business clause

One of the most important interim covenants in any M&A agreement is that related to conducting 'the business in its ordinary course of business and in accordance and consistent with the target's past practice'. The ordinary course of business clause plays a crucial role in ensuring the smooth progression of a transaction. This type of clause is designed to ensure that, between the signing of an agreement and its closing, the target company continues its operations consistent with its past practices and without taking any extraordinary actions that could affect its value or the terms of the deal. In essence, it is a protective measure that seeks to maintain the status quo of the business during the interim period.

This clause provides a clear framework in which the seller can operate the business without breaching the agreement. It allows the seller to make regular operational decisions, manage day-to-day activities and address routine matters without seeking the buyer's approval. However, significant decisions, such as selling a major asset, entering unusual contracts or making substantial changes to business operations, would typically fall outside the 'ordinary course of business' and thus require the buyer's consent.[7]

For the buyer, the clause acts as a safeguard, ensuring they receive the business in the condition they expected when the deal was struck. It offers protection against any unexpected or drastic changes that could adversely affect the value or prospects of the target company.

While the concept seems straightforward, it can sometimes be a source of contention. The term 'ordinary' can be subjective, and what one party considers routine, another might view as extraordinary. Therefore, buyers should aim to include a list of all specific actions that are expected to require buyer consent, while sellers should aim to have specific exceptions (usually listed on a schedule) for actions that are in the pipeline or likely to occur between signing and closing.

The following are examples of items that generally expressly require buyer consent during the interim period:

- any amendments to the target's by-laws or other corporate documents;
- payment of dividends or other distributions;
- granting of employee benefits that did not exist prior to signing;
- indebtedness outside the ordinary course of business or beyond a specified performance metric;
- granting of liens over certain assets;
- entering into agreements with related parties;
- to anticipate payments of any debt or liability; and
- acquisitions, investments or disposition of assets outside the ordinary course of business.

In some cases, sellers may also undertake the obligation to keep the buyer informed or provide reports about the target business.

Material adverse effect clause

In most purchase agreements, the closing is conditioned upon the absence of breaches of representations and warranties made by the seller or the target as a result of which there has been, or is reasonably expected to be, a material adverse effect (MAE). In jurisdictions such as New York and Delaware, courts carefully

7 See Joe Castelluccio and Jenna Miller, 'Pre-closing covenants and the pandemic', 2020 *M&A Journal* 20(4), www.mayerbrown.com/-/media/files/perspectives-events/publications/2020/04/vol-20-no-4-the-ma-journal.pdf.

assessed the standard of an MAE clause and have been very reluctant to allow buyers to refrain from closing under an MAE clause, requiring that the buyer shows the occurrence of unforeseeable events causing sustained and severe business decline. The MAE standard is very high in these jurisdictions. However, if the purchase agreement is governed by the law of a Latin American country, there is uncertainty as to the legal standard set by MAE provisions.

For instance, in Argentina, it is unclear if a court may resort to the frustration of purpose doctrine provided for in Section 1090 of the Civil and Commercial Code,[8] which enables a harmed party to terminate a contract if the conditions set forth in Section 1090 are met.

Also, MAE provisions are used to qualify certain representations, undertakings and events of default, which could be deemed to fit within the provisions of the Civil and Commercial Code that regulate the ways in which a contract can be validly terminated by a party due to a counterparty breach. Section 1084 of the Civil and Commercial Code provides that for a party to claim for the termination of the contract, the breach must be 'of the essence' in connection with the purpose of the contract.

Notwithstanding the above, a Latin American court would likely re-categorise the clause into the legal concept of *force majeure*, as this is more akin to civil law jurisprudence than MAE provisions.

Efforts clause

Another key issue concerning interim covenants is the level of effort that buyers undertake to close transactions. Common variations include 'best efforts', 'reasonable efforts' and 'commercially reasonable efforts'. Among M&A practitioners, it is generally understood that each variation represents a different level of commitment:

- best efforts: this implies the highest level of commitment. A party must take all necessary steps, even if costly or burdensome, to achieve the desired outcome;
- reasonable efforts: this is a more moderate commitment, requiring a party to act diligently and prudently, but not necessarily to the point of incurring significant costs or risks; and

8 Section 1090: 'The definitive frustration of the purpose of the contract authorises the harmed party to declare its termination if it is caused by an extraordinary alteration of the existing circumstances at the time of its signing, unrelated and beyond the control of the parties and that exceeds the risk assumed by the affected party.'

- commercially reasonable efforts: this often takes into account industry standards and practices. It requires a party to exert effort consistent with sound business judgement and practice, balancing the desired outcome against potential costs and risks.

Again, it is uncertain how these standards would be construed under local law in Latin America. Jurisdictions such as Delaware have a body of case law distinguishing 'best efforts' from all other variations that generally require only 'reasonable effort' action from the buyer. In addition, in M&A transactions there is a clause known as the 'hell or high water' (HHW) clause, which requires the buyer to take all actions required for closing, even if adverse consequences are suffered along the way. Therefore, under an HHW clause, a party must do whatever is necessary, regardless of the cost involved and the difficulties that may arise, to achieve the desired result. This type of covenant is commonly used when the buyer must obtain something from a third party to close the transaction (e.g., an authorisation from the antitrust authority or the authority that regulates a particular economic sector).[9]

Conclusions

To excel in M&A deals in Latin America, it is crucial to have a deep understanding of the region's unique legal and regulatory idiosyncrasies.

Deals in Latin America have certainty thanks to the authorisations and clauses established by law, which provide a degree of investor protection. In that sense, it is possible to negotiate with contractual language to ensure that the deal is carried out to the benefit of both parties and that both parties comply with the covenants established in the agreement.

While specific terms of M&A transactions are standard no matter the jurisdiction, it is vital to understand that each country in Latin America has specific requirements that apply differently, especially in terms of antitrust authorisation.

Consequently, seasoned and quality legal advice is crucial for businesses to thrive in the ever-challenging Latin American landscape.

9 See 'Los mejores esfuerzos (best efforts) en la contratación corporativa y financiera' available at https://revistas.up.edu.pe/index.php/forseti/article/download/1756/1579/.

CHAPTER 14

Directors', Senior Executives' and Managers' Fiduciary Duties in Chilean M&A Deals

Juan Andrés Bretón and Roberto Carrillo[1]

Introduction

Due to the size of the Chilean market, it is common for directors, senior executives and managers of Chilean companies to hold similar positions in related companies, including clients and suppliers, as well as to have an interest or relationship in the transactions that their companies wish to carry out, whether as shareholders, partners, investors or stakeholders.

Directors, senior executives and managers must carry out specific actions to fulfil their fiduciary duties to the company and its shareholders. This is particularly true with respect to those evaluating an M&A transaction as they must address specific considerations.

The purpose of this chapter is to analyse some common issues surrounding all M&A transactions and business structuring in general in Chile. This chapter provides an overview of fiduciary duties and insider trading regulations in Chile and their application to the M&A stages, particularly with respect to due diligence and the exchange of information thereunder.

Additionally, the chapter offers an overview of the implications of the new law that systematises economic crimes and offences against the environment (the Economic Crimes Law (ECL)), which establishes a special legal status for crimes perpetrated in the business sphere and is expected to become a heightened area of diligence, as well as the management of post-closing exposure thereunder.

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Trends and criteria from local regulators are presented, and practical recommendations are identified, to provide guidance for those wishing to invest in Chile, as well as for directors, senior executives and managers of Chilean companies who are involved in daily business decision processes.

Management's fiduciary duties

Directors' fiduciary duties

Company directors have certain fiduciary duties, such as the duty of care and diligence, the duty to be informed, the duty of confidentiality and the duty of loyalty, in addition to their general responsibilities in the administration of the company.

By virtue of the duty of care and diligence, in the exercise of their functions directors must employ the care and diligence that people ordinarily use in their own businesses, and they are jointly liable for any damage caused to the company or shareholders by their fraudulent or negligent actions.

The duty to be informed entails the right to be, and the duty of being, informed about the business, as well as the duty to inform the shareholders, authorities and public in general.

The duty of confidentiality implies that directors must maintain confidentiality about the company's business and of the information to which they have access due to their position, as long as it has not been officially disclosed. Consequently, they may not disclose this information to third parties, particularly current or potential competitors of the company, even if they are shareholders of the company, by any means, including verbal, written or electronic means.

Finally, the duty of loyalty means that directors must always act in the best interests of the company, fulfilling their duties independently and loyally. As a result, even if they have been appointed by a group or class of shareholders, they have the same duties towards the company and other shareholders as all other directors.

Regarding the scope of application of these duties, in accordance with Chilean law, managers (or those acting in lieu thereof) and senior executives of a company are subject to the fiduciary duties of directors, to the extent compatible with the responsibilities of their position or function. Accordingly, when the fiduciary duties of directors are discussed, this also applies to senior executives and managers.

Compliance of fiduciary duties

The compliance of fiduciary duties in corporate practice presents several challenges for directors. In this context, the Financial Market Commission (CMF) has provided guidance on the specific behaviour that directors must adopt to strictly fulfil their fiduciary duties.

In this sense, directors must assume an active and leading role in the exercise of their fiduciary duties. For example, in the context of the duty of care and diligence, when a general manager becomes aware of situations that may expose the company, they must disclose this information to the board of directors so that the directors can adopt the corresponding measures, thus discharging their own fiduciary duties. This was the CMF's conclusion in a case in which a general manager failed to inform the board of directors for months that irregular charges were being made to a trade union through a related company of the company he worked for.[2]

In complying with the duty to be informed, directors can request copies of documents they deem relevant to make decisions proposed by management, subject to the duty of confidentiality.[3] They can also specify that the agenda for each board of directors' meeting must sufficiently specify the matters to be discussed, to properly exercise their right to be informed prior to the meeting.[4]

In observing the duty of loyalty, directors must ensure the correct approval of transactions between related parties (OPRs), strictly following the regulations established by Chilean law. In this regard, the CMF has stated that directors must disclose whether they have any personal interest in an OPR. Likewise, directors cannot exempt an OPR from legally required approvals based on a laxly drafted 'regular operations policy'.[5]

Likewise, when contracting with a related party requires board approval, the analysis of several independent competing proposals is required, and it is insufficient to simply state that the related party has offered arm's-length terms and conditions. Otherwise, directors would be in breach of the duties of care and diligence.[6]

2 Exempt Resolution No. 7,932 issued by the Financial Market Commission (CMF) on 23 December 2021.

3 Ordinary Official Letter No. 35,388 issued by the CMF on 5 May 2022.

4 Ordinary Official Letter No. 8,205 issued by the CMF on 23 April 2015.

5 *Política de operaciones habituales*. Exempt Resolution No. 3,259 issued by the CMF on 6 July 2020.

6 Exempt Resolution No. 640 issued by the CMF on 28 January 2021, and Exempt Resolution No. 3,207 issued by the CMF on 24 June 2021.

The duty of confidentiality also stands as an essential fiduciary duty in corporate governance matters. Its fulfilment allows the protection – unless otherwise indicated by applicable law – of the confidentiality of the company's information to which the board of directors has access as an administrative body in the performance of its duties.

Discretion and responsible judgement are crucial when management is requested to disclose certain corporate information. To illustrate the latter, in the case of a company that was requested by one of its shareholders to disclose certain legal opinions that were commissioned to analyse a capital increase, the CMF determined that the management of the disclosing company must carefully analyse whether the information should be disclosed to shareholders or the market. Therefore, because the management did not consider the information to be of interest or essential, it was determined that there was no obligation to disclose it.[7]

Following the same logic, if the minutes of board meetings are confidential, the shareholders' meeting cannot lift that confidentiality, not even to read them in a meeting.[8]

The proper fulfilment of fiduciary duties, especially those of care and diligence, confidentiality and loyalty, allows for the preservation of the separation of the different corporate instances in which certain information is produced, worked on and disclosed. This avoids confusion where the same person has the role of director, general manager and shareholder representative in the same company.

Fiduciary duties in M&A processes: practical considerations for adequate compliance

During the due diligence stage, or in the determination of the transaction price, it is common for confidential information to be collected from the target company or business group. This information is typically disclosed to the potential buyer through a data room, which may also include third parties such as the potential buyer's legal or financial advisers.

The CMF has advised that this situation requires careful analysis to avoid a breach of the duty of confidentiality. To safeguard corporate interest, it is imperative that a confidentiality or non-disclosure agreement (NDA) is entered into

7 Ordinary Official Letter No. 11,479 issued by the CMF on 15 April 2019.

8 Ordinary Official Letter No. 12,540 issued by the CMF on 10 May 2017, and Ordinary Official Letter No. 22,766 issued by the CMF on 13 September 2016.

with the third party that will have access to the company's information.[9] However, the existence of an NDA does not automatically exempt the disclosing company from liability to third parties with whom it has confidentiality obligations over the information disclosed in the due diligence process. In this case, it is necessary to review each contract and the terms under which confidentiality obligations were entered into. This may involve the company obtaining express authorisation from the third party before disclosing the confidential information.

As a component of diligence on compliance with fiduciary duties, buyers are advised to ask sellers for representations and warranties (R&W) in the acquisition agreement that the target companies have entered into, and only with the OPRs that have been disclosed during due diligence and have been approved in accordance with Chilean law.

Additionally, if the transaction involves a publicly traded company or a company subject to reporting essential information to the CMF, details surrounding the M&A transaction could be considered as essential information for all parties involved (the acquiring company, selling company or target company). In that case, all relevant boards of directors will be required to declare the existence of pending deal negotiations as confidential information. However, this confidentiality has a finite duration and must be lifted when the justifying reasons cease to exist.

Another element to consider relates to the scenario in which an investor acquires a company in Chile and decides to remove the previous management. In this context, any settlement negotiated with the directors should be limited to the contingencies known as at the date on which the settlement is signed or agreed upon. This approach prevents the buyer from assuming fines or sanctions resulting from breaches of directors' fiduciary duties or applicable regulations that occurred in the past and of which they were unaware.

Directors and executives as insiders

Inside information rules

In Chile, not all company information is considered inside information; it must meet certain specific requirements. First, the information must pertain to specific matters, such as the issuers of securities, their businesses or the securities that they have issued. This information must not have been disclosed to the market and must have the potential to influence the trading of publicly offered securities.

9 Ordinary Official Letter No. 21,197 issued by the CMF on 29 August 2016. See the 'Preliminary Legal Documents in Mexican M&A Transactions' chapter in this guide.

To properly regulate the access, use and disclosure of inside information, clear duties and prohibitions are established. There is a special duty to maintain the confidentiality of this information, a prohibition on using it directly or indirectly for personal or third-party benefit and a prohibition on engaging in transactions with the affected securities or benefiting from operations related to the information. It is also prohibited to disclose this information to third parties and to recommend engaging in transactions with the relevant securities, either directly or indirectly. With the introduction of the ECL, these actions became economic crimes and apply to anyone who has access to this information due to their office, position, activity or relationship, without the need for a specific connection to the issuing company or other individuals with inside information. Furthermore, the prohibition on using this information is absolute, and includes the order to cancel or modify a security, in addition to the acquisition or transfer thereof.

The Chilean legislator has established presumptions regarding individuals in possession of inside information. These presumptions involve directors, managers, administrators and senior executives of the issuer, as well as those working for the issuer's controlling persons or representatives engaged in the transfer of control.

These presumptions do not preclude the possibility of sanctioning other individuals who do not hold these positions or have specific relationships with the company under the rules and prohibitions described above.

In summary, the Chilean legislator sets precise requirements for considering information as privileged and imposes strict duties and prohibitions on those who have access to it. Additionally, presumptions of those in possession of inside information strengthen and ensure more effective application of these regulations.

Common compliance issues with insider trading regulations

As discussed above, the use of inside information in Chile is associated with a strict set of rules and prohibitions, and, as a consequence, several issues have naturally arisen in relation to its compliance, which the CMF has sought to address within its jurisdiction.

One of the most prominent issues – and corresponding rulings – is that the prohibition on using inside information is absolute. This means that it is not possible to defend oneself by alleging any personal connection or economic justification with the securities acquired while having access to inside information. The CMF has concluded this, most notably in the case of the director of a bank who acquired shares while in possession of inside information. At the time, the director argued that the shares were not acquired for speculative purposes but solely to increase his stake, which was confirmed as he did not sell the shares. However, this defence was rejected by the CMF.[10]

In a similar case, the defence was based on the long-standing family relationship between the individual investigated and the company for which the individual had inside information. This defence was also dismissed.[11]

Another recurring issue arises around whether the financial statements constitute per se inside information about the company they pertain to, or whether it depends on their potential to influence the trading of securities issued by that company. In this regard, on several occasions the CMF has held that, by their nature, financial statements constitute inside information per se, regardless of their content.[12]

An example of this is the dismissed defence of a director who received access to the company's financial statements during a board meeting and, before their publication, traded company securities. Although he sold the securities because they were not useful to him, the CMF deemed that a company's financial statements are always considered inside information, which implies an absolute prohibition to trade.[13]

For foreign investors interested in investing in Chile, it is crucial to note that the concept of inside information is broad and encompasses multiple scenarios, including the evaluation stage of an M&A transaction. In one particular case, certain individuals alleged that the M&A transaction was in its initial stages and, therefore, was only a potential transaction, which exempted them from meeting the inside information requirements. However, the CMF determined that the law does not require inside information to be related to 'business that is certain' but that 'any information' can constitute inside information. The CMF has also clarified that only the 'potential' to influence the securities' trading price is necessary, without requiring it to actually materialise.[14]

In connection with the above, it is not required that the individual has detailed knowledge of the transaction in question; it is sufficient that they become aware of its essential elements, such as the parties involved, the purpose of the transaction and its price and intended effects.[15]

10 Exempt Resolutions Nos. 7,603 and 7,604, both issued by the CMF on 8 November 2019.
11 Exempt Resolution No. 4,311 issued by the CMF on 11 July 2022.
12 Exempt Resolution No. 7,603 issued by the CMF on 8 November 2019.
13 Exempt Resolution No. 3,087 issued by the CMF on 12 June 2020.
14 Exempt Resolution No. 4,311 issued by the CMF on 11 July 2022.
15 Exempt Resolution No. 2,470 issued by the CMF on 6 April 2023.

Proper handling of inside information in M&A transactions

In situations where it is detected that negotiations or the closing of a transaction could involve inside information about publicly offered securities, it is essential to consider from the outset how details of the negotiations or the completion of the transaction will be disclosed to local authorities, stock exchanges and the general public, as appropriate (whether in the letter of intent or the memorandum of understanding). This ensures compliance with the law and that when made public the information loses its privileged status.

This measure takes on significant importance in cases where there is a legitimate interest in maintaining the confidentiality of the transaction, in a context where not all expected effects have occurred. A common example is when, after an initial closing, the effects of the transaction are subject to specific conditions, such as obtaining approvals or authorisations.

In these circumstances, transparency and compliance with appropriate disclosure protocols are essential to ensure that sensitive information is handled correctly and to avoid any suspicion of improper use of inside information. This protects the reputation and credibility of the parties involved, and compliance with existing regulations governing the disclosure of market information is upheld.

In an increasingly demanding environment concerning transparency and regulatory compliance, adopting solid and proactive practices for information disclosure is essential for preserving the trust of investors and the market as a whole. Therefore, from the outset of any negotiation, the appropriate disclosure aspects must be considered.

ECL challenges

Overview

In August 2023, the long-awaited ECL came into force. This new legislation introduces the concept of economic crime associated with economic and business activities. It incorporates some new and some partly modified criminal offence classifications. For example, some of these crimes are found in the Corporation Law (LSA), the Securities Market Law (LMV), the Criminal Code, the General Banking Law, the Tax Code and the Law Regulating the Financial Market Commission, among others. Additionally, the ECL has introduced material amendments in matters concerning environmental offences.

One of the main characteristics of the Law is the organisation of economic crimes into four categories, with the purpose of establishing a special system for determining more severe penalties and sanctions for individuals involved in these crimes and a special system of substitute penalties. Additionally, special aggravating factors have been incorporated that are not contemplated in the Criminal

Code; these apply a qualified or highly qualified aggravating factor to cases involving high or very high culpability, as appropriate. These aggravating factors will particularly affect individuals who hold significant leadership roles or are part of a company's senior management.

Regarding penalties, all economic crimes will be punished with day fines in addition to disqualification from holding public or managerial positions (such as director or senior executive) and from contracting with the state. In the latter case, the disqualification will also affect the legal entities to which the individual belongs. The Law also provides for the confiscation of gains derived from crimes.

Regarding the criminal liability of legal entities, in broad terms the ECL:

- extends the list of base crimes and active subjects;
- establishes new grounds for criminal liability;
- expands the circle of individuals who can generate criminal liability for legal entities;
- generates a change in the definitions of compliance programmes; and
- establishes new sanctions.

Key aspects of LMV and LSA modifications

In relation to the main regulatory frameworks applicable in an M&A transaction and the operation of directors, senior executives and managers, it is relevant to highlight the modifications that have been made to the LMV and the LSA, as well as the creation of new crimes in the latter.

The catalogue of crimes established in the LMV has been reviewed, expanding certain scenarios to cover a wider range of behaviours. This means that now, not only directors, senior executives or managers of an issuing company can be criminally liable, but anyone who engages in certain behaviours, such as providing false information to the market, can also be considered criminally liable.

As for prohibitions related to insider trading, significant modifications have also been introduced. The absolute prohibition of using this information for one's benefit or that of third parties, as well as of engaging in transactions that can generate benefits by taking advantage of the information, has been reinforced.

Moreover, the requirement that the insider must have a connection with the issuer of that information has been eliminated.

In terms of economic crimes concerning credit ratings, the crime of providing a rating that does not correspond to the risk of the rated securities now applies to the rating agency, and collusion with another person is no longer required for this to be classed as an offence. Similarly, the requirement that the alteration, concealment or destruction of information of a rated issuer must have the purpose of achieving a false assessment of a financial situation for the conduct to be considered a crime has been removed.

In the case of the LSA, new offences have been introduced that will have a direct impact on M&A transactions. These modifications include the creation of specific offences related to directors, senior executives or managers who, in the reports, financial statements or other documents intended for shareholders, third parties or company management, deliver or approve false information about the legal, economic or financial situation of the company.

Taking inspiration from Spanish legislation, directors who, taking advantage of their majority position, adopt an abusive agreement are criminally sanctioned. This includes any controlling persons who, taking advantage of their status, induce the board of directors to adopt or execute an abusive agreement. Although the ECL does not define or specify the concept of abusive agreement, it does establish that it must be carried out to obtain a benefit for oneself or an economic benefit for a third party, to the detriment of the other partners and shareholders and without producing a benefit for the company.

While these modifications send a clear message about the need to respect the rights of shareholders and interested third parties, some important observations arise.

First, unlike Spanish law, the new regulations refer only to agreements adopted in board meetings and not in shareholders' meetings, which is striking because the LSA regulates shareholder decisions but not specifically board meeting decisions. Second, the new provision does not state that the abusive agreement must result in harm or loss to the company, but rather that it does not benefit it, so an agreement that has a neutral effect on the company could eventually be considered abusive. Third, as an abusive agreement is also considered to be one in which the controller of the company agrees or participates in its execution, it would not be necessary for it to be an agreement proposed by the directors appointed by the votes of the controllers of the company, it would be sufficient for them to have voted for it.

Finally, if a controlling person could induce an abusive board agreement, it would raise questions about the directors' duty of loyalty, as established in the LSA. Under this duty, directors of a company must act at all times in the company's interest and fulfil their duties independently and loyally, without failing in their duties to the company and the shareholders on the pretext of defending the interests of the shareholders who appointed them. In other words, in accordance with the duty of loyalty, directors should not be induced by the controller who appointed them to adopt a specific resolution. Moreover, the regulation does not address the situation of abuse that minority directors can generate in deadlocks or vetoes by unanimous quorums established in shareholder agreements prior to an acquisition.

These reforms seek to ensure a transparent and effective governance environment in the economic and business sphere. They have updated, elevated and adapted the country's criminal legislation to meet modern business needs. However, it is necessary to carefully analyse how economic crimes and the modifications introduced by the ECL will be applied in practice, not only in terms of the case law that the courts will develop in corporate crime, but also concerning the understanding and criteria that will be developed by the system's various actors, such as prosecutors during the procedural investigation and accusation stages, and plaintiffs and defendants in their respective roles within the criminal system. Examining these interactions and dynamics will help to determine whether adjustments to the legislation will be required to ensure its effectiveness.

Avoiding infringing ECL in M&A transactions

As illustrated above, the implementation of this new legislation could lead to several complexities, as it affects multiple aspects of the Chilean business environment. For this reason, the development and evolution of corporate practice in relation to the application of the ECL should be closely followed.

Furthermore, in the context of traditional document review, especially within due diligence processes, it is essential to analyse the minutes of board meetings held following the introduction of the ECL, particularly in terms of the new offence of abusive agreements. Companies will also need to adjust their corporate governance, compliance programmes, crime prevention models and internal policies to prevent their directors, controlling persons and employees from potentially perpetrating any of the offences or violations introduced by the ECL.

In this regard, crime prevention models can exempt companies from criminal liability as long as they meet certain requirements, such as identifying activities or processes that pose risks to the legal entity, implementing protocols and procedures to prevent and detect crimes, and disclosing these protocols to all employees and workers.

Regarding the negotiation of R&Ws, if the seller is a controlling person, either on its own or jointly with another entity or individual in a company or a joint-stock company, it is recommended to include a statement that ensures that the board of directors of the company has not been induced to adopt agreements that may be considered abusive. It is also important to assess, in diligence, whether the liability insurance policies contracted for these persons cover risks related to the ECL. This should also be taken into account when selecting the executives of the acquired company after the closing, as they will assume greater exposure and financial responsibility.

Finally, in the context of the negotiations of a purchase agreement in general, it is essential to consider the additional exposure that the aforementioned elements represent for the company and its management when determining the amount necessary to be placed in escrow or in negotiating the limits of sellers' liability. These aspects must be handled with special care to protect the interests of all parties involved, while also ensuring that these elements do not impede the transaction or make it unfeasible.

Conclusion

In summary, M&A transactions in the Chilean market require the assessment of several local legal and regulatory obligations to which companies and their administrative bodies, senior executives and corporate boards are subject. Moreover, Chilean legislation increasingly raises the standard in terms of compliance with fiduciary duties (in relation to the company and its shareholders) on company directors, senior executives, administrators and managers. Violations of, and penalties for, these duties have been recently broadened by the ECL.

With the recent introduction of the ECL, companies and their senior executives face greater responsibility. Both investors looking to establish themselves in Chile and individuals occupying leadership positions in local companies must thoroughly understand the complexities of the new regulatory scenario introduced by the ECL. This will enable them to improve their business and plan how to structure certain transactions, even in a transaction's preliminary stages.

In this context, it is crucial to consider the interpretation of regulators, particularly the CMF, because their guidelines play a decisive role in the practice of corporate law and in the promotion of investments in Chile. Therefore, to ensure a successful entry into the Chilean market, as well as strict compliance with current regulations, investors and senior executives must be aware of the implications of the ECL and align themselves with the guidelines issued by sector regulators in their strategies and in the structuring and implementation of their business transactions in the country.

CHAPTER 15

A Deep Dive into Acquisition Finance in Latin America

Eduardo Rojas Brandao, Francisco Javier Garibay Güémez and Raúl Fernández-Briseño[1]

Introduction

When structuring an acquisition, one of the paramount decisions confronting the involved parties is the strategy to obtain financing. This financing decision must strike a harmonious balance: the buyer seeks efficient financing that neither inflates the overall acquisition cost nor curtails operational flexibility post-closing; simultaneously, the seller's priority is to ensure closing certainty and timely receipt of the purchase price at closing.

In the ever-evolving landscape of global mergers and acquisitions (M&A), Latin America stands as a region of unique opportunities and challenges. As businesses seek to expand their footprint, the intricacies of acquisition finance in this diverse region come to the forefront. While acquisition finance serves as a powerful tool for funding acquisitions, its structure, parties, documentation and regional specifications in Latin America demand a deep understanding.

This chapter reviews the current M&A trends in Latin America, examining the structure of acquisition financing in the region, the role of various parties, the importance of due diligence and the specific protections and considerations essential for navigating acquisition finance in Latin America.

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Current M&A trends

In 2021, the Latin American region witnessed a surge in M&A, with transactions totalling approximately US$168.3 billion.[2] Yet, 2022 unveiled a set of global challenges, which resulted in the region experiencing a 35.9 per cent decline in M&A activity compared to the preceding year, culminating in M&A transactions worth US$106.9 billion.[3] Factors such as escalating inflation, the energy crisis, falling stock prices and rising interest rates contributed to this slowdown. Given the intrinsic relationship between M&A and acquisition finance, these external challenges also had implications for financing structures and the availability of funds.

Fast forward to the present, and despite the prevailing global uncertainties, Latin America's M&A sector demonstrates resilience, although not quite reaching the levels seen prior to the pandemic. KPMG's 2023 survey on M&A in Latin America underscores this sentiment, highlighting a reinvigorated momentum in the region's M&A activities.[4]

Traditionally, Brazil has been at the forefront of M&A activity in the region, primarily due to its size, abundance of natural resources and strategic positioning on the global map. In recent times, Mexico has caught the eyes of investors, particularly as 'nearshoring' is unfolding. As global economic dynamics evolve, many investors are recalibrating their strategies. While Asia has traditionally been the manufacturing and services hub for the US, a combination of factors, including proximity to the US market and a skilled young labour force, has propelled Mexico as a preferred alternative. This movement, termed 'nearshoring', is yet to reach its peak in Mexico, indicating further potential growth in transactions in the country.[5] Investments in infrastructure and public services will be paramount for the exploitation of nearshoring prospects to reach its potential.

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2 See Sebastián Osorio Idárraga, 'Mergers and Acquisitions dropped by 30% in LatAm in 2022', Bloomberg, 27 December 2022, www.bloomberglinea.com/english/mergers-and-aqcuisitions-dropped-by-30-in-latam-in-2022/ (last visited 26 September 2023).

3 ibid.

4 See 'In an uncertain world, Latam M&A is on the rise: KPMG 2023 M&A in Latam Survey', https://kpmg.com/xx/en/home/insights/2023/06/kpmg-2023-m-and-a-in-latam-survey.html (last visited 18 September 2023).

5 See 'Nearshoring in Mexico', www.mayerbrown.com/-/media/files/perspectives-events/publications/2023/05/whitepaper_nearshoring_fnl.pdf?rev=0383024119224587a4a922b07f9632bd (last visited 26 September 2023).

Also in Mexico, several traditional sectors have attracted heightened attention in terms of acquisitions. The pharmaceuticals, manufacturing, premium retail, spirits and fintech sectors have witnessed a notable increase in acquisition volumes. However, the strengthening of the Mexican peso may pose constraints on their sustained growth.

Amid the evolving landscape of M&A in Latin America, Costa Rica is rapidly carving a niche for itself, emerging as a sought-after destination for deals. Its reputation as a politically stable and economically robust nation instils confidence in potential investors. Furthermore, its progressive approach to environmental policies is notable; not only is the nation spearheading efforts to reverse deforestation, but it is also championing broader ecological initiatives. This environmentally conscious stance aligns seamlessly with the priorities of investors inclined towards environmental, social and governance criteria. Recognising the potential of foreign direct investment, Costa Rica has also been proactive in rolling out new initiatives designed to attract global investors. These endeavours, ranging from reducing bureaucracy to opening up sectors such as the agriculture, food, tourism, manufacturing and services industries to foreign capital, further accentuate the country's appeal in the M&A domain.[6]

Optimism about the M&A landscape comes with its fair share of caution. A majority of investors and corporations are optimistic that the volume of acquisitions will increase over the next couple of years, both from within the region and externally. This sentiment is supported by the potential for greater regional integration and an influx of foreign investment. Yet, investors are well aware of the geopolitical and economic risks inherent to the region. Concerns range from potential breakdowns in the rule of law to more dramatic shifts such as governments nationalising private entities or diminishing incentives for foreign investment. These factors could easily dissuade potential investors, putting a damper on the otherwise promising M&A forecast for Latin America.

However, its diverse economies and vast potential ensures that Latin America remains an exciting prospect for M&A activity. The interplay between the region's traditional strengths, emerging trends such as nearshoring and the various strategies being employed in countries such as Costa Rica, and the ever-present risks, makes it a dynamic and intriguing region for investors and corporations alike.

6 See 'Costa Rica Takes Another Step to Bring Foreign Investment to the Country's Rising Cities', CINDE, 24 February 2023, www.cinde.org/en/essential-news/costa-rica-takes-another-step-to-bring-foreign-investment-to-the-countrys-rising-cities (last visited 18 September 2023).

Acquisition finance structure

Acquisition finance, in essence, refers to the use of debt to fund the acquisition of a business. The finance dynamics for acquisitions require a delicate equilibrium; not only should the financing be cost-effective, but it should also provide the purchaser with ample latitude for effectively governing and further growing the newly acquired entity.

There are several primary considerations to take into account when structuring an acquisition finance:

- the nature of the buyer, which could be either a strategic entity or a financial investor;
- the type of M&A transaction, whether it is a result of direct negotiations or it emerges from a competitive bid; and
- the availability of financing sources; the accessibility to financing options plays a pivotal role in dictating the financing structure for both buyers and sellers.

Nature of buyer

A strategic buyer's motivation often revolves around the potential for expansion, whether that is horizontal or vertical. Their pursuit is primarily for the acquisition of businesses that can be seamlessly integrated into their prevailing operations. Hence, their financing preferences usually lean towards affordable options that would not hinder their operational or expansionary agility. Financial buyers – for example, private equity firms – are concerned with future return on their investment. They identify businesses with growth potential or that can operate more efficiently, hoping to achieve lucrative returns on their investment within a typical period of five to seven years.[7]

Taking this into consideration, strategic buyers commonly lean towards unsecured short-term or bridge loans, which have full recourse to their financial statements. In contrast, financial buyers usually opt for financing extended to a special purpose vehicle, which is formed specifically for the acquisition. This loan is usually secured by the vehicle's assets, which normally include the shares of the target entity, as discussed further below.

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7 See 'Strategic vs Financial Buyer', Corporate Finance Institute, https://corporatefinanceinstitute.com/resources/valuation/strategic-buyer-vs-financial-buyer/ (last visited 20 September 2023).

Type of M&A transaction

An M&A transaction can be the result of direct negotiations between the seller and the buyer or an auction process in which prospective acquirers place bids to compete against each other.

Therefore, a direct negotiation offers a more conducive environment for the buyer, allowing for negotiations that can yield favourable acquisition agreement terms, translating into more advantageous financing. In a competitive bid, sellers meticulously assess buyers' financing prospects and the associated risks of unavailability of funding at closing. Sellers typically favour bids accompanied by financing assurances. Hence, commitment letters frequently feature 'SunGard' provisions, which essentially tie funding conditions at the closing phase to, inter alia, fundamental representations and warranties being true and correct, there being no material adverse change (MAC) in the target company and the successful execution of collateral documentation (funding typically occurs before the perfection of these documents (such as registration in public registries), which will be included as a post-funding covenant).[8]

Availability of financing

Marked by their low debt rates, 2020 and 2021 presented buyers with the option to wholly or partly fund their acquisitions via debt. Despite the shift in the economic conditions in 2022 and 2023, buyers in Latin America persistently explored bank, private placement and debt capital markets. Historically, the most prevalent acquisition financing mode in the region has been the bridging loan route.

Unlike the US, where acquisitions are frequently directly funded through capital markets, Latin America displays a strong preference for bridging loans. Several factors contribute to this preference: there is restricted access to capital markets, the region's markets are generally smaller and less liquid than those in the US, and the process of listing with stock exchanges can be cumbersome and expensive.[9] The bridging loan mechanism elevates the reliability of funding availability at the

8 See Jennifer T Wisinski, 'Negotiating Financing Provisions in Mergers', Reuters, May 2023, www.reuters.com/practical-law-the-journal/transactional/negotiating-financing-provisions-mergers-2023-05-01/ (last visited 20 September 2023).

9 See Michelle del Campo and Estephanie Suárez, 'Por qué las startups en México y Latam no debutan en bolsa', Bloomberg, 28 September 2021, www.bloomberglinea.com/2021/09/28/por-que-las-que-las-startups-en-mexico-y-latam-no-debutan-en-bolsa/ (last visited 18 September 2023).

acquisition's closing date, safeguarding the seller's price. Beyond its immediate benefits, a bridging loan also furnishes the buyer with post-acquisition flexibility, granting it the discretion to replace the loan with a term loan or bond.

In recent times, there has been a notable trend towards innovative financing mechanisms, such as equity kickers and seller financing. Seller financing allows the seller to facilitate transactions by providing part of the finance for the acquisition. Equity kickers give the lender an ownership position in the buyer's entity, often in return for a reduced interest rate. They serve as an enticing incentive for lenders, offering the potential for equity participation in a company in addition to interest payments. These two methods are typically employed to finance a portion of the acquisition and become particularly appealing in scenarios where traditional financing sources are not available or are less favourable.

In essence, the landscape of acquisition finance in Latin America is characterised by its distinct regional preferences, strategies and challenges, which prospective buyers must navigate to make successful transactions.

Acquisition finance parties, processes and documentation

Acquisition finance involves various parties and crucial documents. This intricate web defines the terms, conditions and mechanisms that facilitate the financing aspect of any acquisition. This section delves into the primary players in the acquisition finance process, the primary documents that form its foundation and the indispensable role of due diligence.

Parties

Acquisition finance involves three primary parties: the buyer (or borrower), the lenders and the sellers.

As highlighted above, borrowers and buyers in an acquisition financing can be categorised primarily as strategic or financial. Their distinct objectives and acquisition strategies play a defining role in shaping the financing structure.

The lenders or financing sources are the entities providing the required financing for the acquisition. Lenders in Latin America often consist of local banks or non-bank lenders as well as international banks. Taking into account the region's preference for the bridging loan mechanism, the lenders might opt for various financing structures such as bilateral, syndicated or club deals, depending on the deal's complexity and the parties involved.

Sellers are focused on receiving the agreed-upon value of their assets or enterprise, which is why they endeavour to ensure that buyers have the necessary financing at closing to meet the purchase price. This is a crucial concern, especially given the nature of M&A transactions, whether it is a private sale or a competitive bid.

The triad of main players in acquisition finance often seek insights from financial consultants and legal counsel. Financial advisers shed light on the financial facets of the transaction, ensuring the terms struck are both favourable and sustainable. Their expertise is invaluable in assessing the viability of the proposed acquisition financing structure. Also, given the legal intricacies of acquisition finance, both borrowers and lenders engage legal counsel. These experts ensure the terms and conditions are compliant with prevailing laws.

In the context of Latin America, acquisition finance deals frequently involve a blend of local and international legal expertise. For example, a cross-border transaction involves both local and foreign law, which typically governs the principal loan agreement (which normally falls under New York law) while observing the required components to consummate the acquisition under the local jurisdiction.

The players in acquisition finance are not limited to these parties. Other pivotal players, such as stakeholders, auditors and regulatory authorities, may have a vested interest in the acquisition finance process.

Due diligence

Prior to the execution of any documentation for an acquisition finance transaction, the debt provider finalises its due diligence. Due diligence serves as the linchpin in the acquisition finance process. Before the green light is given to any financing, it is imperative to comprehensively vet the buyer's and the target company's financial, operational and legal status. This scrutiny helps lenders evaluate the risks and ascertain the deal's viability. It aids in uncovering potential pitfalls or liabilities, ensuring that lenders, buyers and other stakeholders make informed decisions. In essence, due diligence acts as the gatekeeper, ensuring that the financing structure is robust, sustainable and in the best interests of all parties.

Documentation

The terms and conditions of an acquisition finance transaction are laid out in two separate sets of documents, which are executed at different stages of the M&A transaction.

The first set of documents is referred to as the commitment documents. At the outset, buyers and potential financing sources negotiate the core economic, commercial and legal terms. These discussions crystallise into the 'commitment documents'. The first set includes:

- commitment or mandate letters, which delineate the terms under which lenders are obligated to fulfil their commitments;
- fee letters, which outline the fees that will be paid to the lenders, arrangers and agents; and
- SunGard and market flex provisions, both of which frequently find their way into commitment or mandate letters. The SunGard provision outlines specific, limited conditions for funding, ensuring that the necessary funds are available at the close of the M&A transaction. This feature distinguishes acquisition financing from non-acquisition financing. On the other hand, market flex provisions grant arrangers the flexibility to tweak financing terms, which aims to guarantee successful syndications.

The second set is referred to as the definitive documents. During the period between signing the initial agreement and closing the M&A transaction, the involved parties finalise the acquisition's definitive documentation, based on the previously agreed commitment documents. Essential among these are:

- the loan agreement, which is the pivotal document detailing the terms of the loan. In a Latin American scenario, the governing law of this document could be either the local law of the country where the borrower, buyer or target is based, or foreign law – typically New York law; and
- collateral documents, which outline the specifics of the collateral, when applicable. Typically, collateral in an acquisition finance deal comprises the shares or assets being financed, future revenue streams stemming from the acquired assets or entities, or a corporate guarantee, particularly when a strategic player is involved. Although the loan agreement can be governed by foreign law, any collateral documents related to assets located in a Latin American country must comply with that nation's legal framework and stipulations. For example, when the collateral involves shares of the target being acquired, the document should adhere to the local laws and registration requisites needed to formalise the security interest.

Acquisition finance is not merely about pooling funds for an acquisition. It is a meticulous orchestration of parties, documents and processes, each serving as a cog in the M&A process. As Latin America continues its dynamic M&A journey, understanding these components becomes pivotal for investors, corporations and professionals navigating this landscape.

Protections and considerations specific to Latin America

Acquisition financing in Latin America is characterised by its distinct dynamics, shaped by the region's diverse economic, political and regulatory landscape. This section explores key protections and specific considerations for lenders and borrowers involved in these transactions in the region.

As mentioned above, a cornerstone of acquisition financing is the due diligence process. In their quest to minimise risk, lenders review the acquisition agreement, diving into the terms of the acquisition, as well as the profile and assets of the target. This review allows lenders to gain insights into the dynamics between the involved entities. A vital component often embedded within the acquisition agreement is the financing cooperation covenant, which mandates the buyer's collaboration, also ensuring the active participation of the seller and the target.

Providing a primary protective shield for lenders are the commonly named 'Xerox' provisions. Incorporated within the commitment documents, these provisions act as a buffer, shielding debt providers from becoming entangled in transactional disputes that may emerge if an M&A deal falls apart. In essence, they establish a clear demarcation, stipulating that both the buyer and seller refrain from dragging the lenders into litigation. Nevertheless, the buyer retains the right to exercise its rights under the commitment documents. Additionally, acquisition agreements often limit the buyer's liability through mechanisms such as reverse break-up fees, a factor lenders should observe or maybe even require to be included in the agreement. To reinforce these protections, debt providers position themselves as third-party beneficiaries within acquisition agreements, exclusively to secure the right to enforce the Xerox provisions and to ensure that these provisions remain unaltered without their explicit consent.

Within acquisition agreements, specific clauses require thorough attention and examination by financing providers. Definitions concerning MACs and their associated exceptions can profoundly affect the financing framework. To protect their stakes, lenders often advocate for qualifiers that reinforce clarity, especially when the exceptions encompass wide-ranging economic or political circumstances. For instance, if a MAC definition incorporates broad exceptions, a lender would typically expect the buyer to specify that these exceptions are relevant only when 'they solely impact the target and the said impact is notably more severe than on comparable businesses'.[10] Furthermore, lenders must meticulously review and analyse the disclosure schedules, ensuring they identify any exclusions, assess their materiality to the business and determine the presence of substantial liabilities.

Each Latin American country brings to the table its distinct legal regulations and its unique considerations. Some of the most important items to bear in mind when structuring an acquisition financing in Latin America are as follows.

- Collateral documents. In several Latin American jurisdictions, the perfection of collateral demands strict formalities such as mandatory notarisation and registration in public registries. These processes, while ensuring legal robustness, can amplify costs and introduce potential delays, which lenders must factor into their calculations.
- Foreclosure procedures. The region's varied foreclosure procedures, shaped by each nation's judiciary and collateral structures, can be cumbersome and resource-intensive. Lenders should anticipate both the costs and duration of these processes.
- Insolvency laws. Insolvency and bankruptcy laws in Latin America can be difficult to navigate, with each country introducing unique layers of complexity.
- Tax. Withholding tax rates on interest payments can vary considerably across the Latin American nations. While some countries impose rates as steep as 35 per cent, others offer preferential rates, contingent on multiple parameters relating to the nature of the borrower or lender's jurisdiction.
- Foreign exchange controls. The region's fluctuating foreign exchange landscape, with countries such as Argentina imposing stringent controls,[11] requires meticulous evaluation. These controls, often influenced by the broader political and economic context, play a pivotal role when structuring a transaction in the region.

Conclusion

Acquisition finance in Latin America is enriched by the region's distinctive economic, legal and political dynamism. As both local and international businesses continue to harness the potential of M&A in the region, a profound understanding of its acquisition finance dynamics becomes indispensable. Through

10 See 'Lender Concerns in Acquisition Agreements Checklist: Acquisition Finance', https://uk.practicallaw.thomsonreuters.com/8-381-0300?transitionType=Default&contextData=(sc.Default)&firstPage=true (last visited 25 September 2023).

11 See 'Argentina – Foreign Exchange Controls', www.privacyshield.gov/ps/article?id=Argentina-foreign-exchange-controls (last visited 25 September 2023).

meticulous planning, thorough due diligence and leveraging specific protections, lenders, buyers and sellers can craft robust financing structures that cater to their strategic aspirations while mitigating potential risks.

Latin America, with Costa Rica's stable economic and political stance, Brazil's niche M&A market and Mexico's new nearshoring trend among other traditional industries, is poised at an intriguing juncture of growth and global integration. Yet, as with any dynamic region, investors and professionals must remain vigilant. Imminent and upcoming political events, such as the presidential elections in El Salvador, Panama, Mexico, Uruguay and Venezuela and Chile's constitutional plebiscite, coupled with new leadership in Argentina, Colombia, Chile and Brazil, could pivot the landscape. These shifts may either unlock unprecedented opportunities or give way to unforeseen challenges. In this evolving panorama, strategic foresight and adaptability remain key to leveraging Latin America's acquisition finance potential to its fullest.

APPENDIX 1

About the Authors

Claudia Barrero

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Claudia Barrero is a partner at Philippi, Prietocarrizosa, Ferrero DU & Uría. Her legal practice focuses on areas such as corporate, M&A, banking, finance and capital markets, and private clients. Claudia has ample experience of mergers and acquisitions of listed companies, and has extensive experience in capital markets, infrastructure projects and corporate governance matters. She has acted as adviser to issuers on initial public offerings and debt issues, as well as to several Colombian and international clients in matters such as cross-border M&A and all related corporate governance aspects. She has also advised the Colombian government in various privatisation processes, particularly in the energy sector.

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Rafael Boisset is a partner at Philippi, Prietocarrizosa, Ferrero DU & Uría (PPU) and the country manager for Peru. He is an expert in corporate matters as well as in M&A for private and listed companies in various economic industries, representing both sellers and buyers.

He initially joined PPU (formerly Ferrero Abogados) in 2004 and has been involved in M&A and corporate transactions since then. In 2007, he joined Veirano Advogados as an international associate. In 2008, he obtained his LLM in corporate law at Columbia University School of Law, New York. In 2009, he worked as a foreign associate in the New York office of Cleary Gottlieb Steen & Hamilton in its Latin American practice. In 2010, Rafael joined Creel Garcia-Cuellar Aiza & Enriquez in Mexico City. Rafael then rejoined the PPU team, becoming a partner in 2012 and focusing his experience on M&A transactions, banking and finance, and general corporate affairs.

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Juan Bonet is a partner at the firm and leads Deloitte Legal Uruguay. He has more than 15 years of experience advising clients in the financial, mass consumption, renewable energy, extractives, aeronautical and automotive sectors on various corporate, litigation and tax matters.

He has a law degree from the University of the Republic, where he is a Grade III professor of financial law. He has two master's degrees from European institutions, an advanced diploma in international taxation from the Spanish Association of Tax Advisers and postgraduate degrees from US institutions. He has written and published more than 50 works (papers and collective works) in Uruguay, Argentina, Spain, the United Kingdom, the United States and the Netherlands, on corporate issues, energy, corporate governance, international and local taxation, commercial law and bankruptcy law. Many of his works have been cited by the Administrative Litigation Tribunal, the highest court in annulment litigation matters in Uruguay.

For several years, he has been ranked in prestigious legal publications such as *Chambers & Partners* ('Juan Bonet is a very good lawyer with a solid technical knowledge of the local tax regulation and a strong commercial awareness') and *The Legal 500: UK* (Juan is an 'efficient and knowledgeable star associate' and 'highly rated'). Since 2007, Latin Lawyer has highlighted Juan's performance in various relevant deals and operations in Uruguay.

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Eduardo Patricio Bonis is a partner and head of the corporate and M&A practice of Deloitte Legal in Argentina. He has a law degree from the University of Buenos Aires and a master's degree in private international law from the University of Bologna, Italy. He has more than 15 years of professional experience, specialising in corporate law advice, advising both multinational companies and family businesses in various local and international industries. He also has vast experience in mergers and acquisitions, foreign investments, start-ups, foreign exchange law and renewable energy projects.

He is an active member of the M&A Commission of the International Association of Young Lawyers, and is vice president of its Environmental and Energy Law Commission. He is also a member of the Italian Chamber of Commerce in the Argentine Republic and of the Hydrogen Committee of the

German–Argentinian Chamber of Industry and Commerce. He is a speaker at national and international conferences on subjects in his areas of expertise and an author of local and international specialised publications.

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Juan Andrés Bretón is a partner in the firm's corporate law practice. He has extensive experience in M&A, private and corporate law, private equity, corporate governance, foreign investment, tax and corporate reorganisations.

His practice focuses on M&A and financing, as well as on advising and negotiating highly complex commercial contracts. He has participated in the restructuring of various organisations, and in cross-border transactions, advising boards of directors, shareholders, managers and chief legal officers in their decision-making processes, both in local and foreign companies, in a wide range of sectors, such as finance, renewable energy, mining, public transportation, steel, food and beverages, and telecoms.

He has assisted many companies in their growth and expansion on the national market, including in the incorporation and start-up of subsidiaries and entities in Chile.

Juan Andrés has a law degree from the Faculty of Law at Diego Portales University and a master's degree in taxation from the University of Chile School of Business and Economics. He began his career in the corporate law practice of Eluchans and joined FerradaNehme in 2017.

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Luis Burgueño is a partner at Von Wobeser y Sierra, with more than 30 years of experience in M&A, corporate matters and transactions in general. He is a member of the executive committee of the firm and is co-leader of the firm's energy and natural resources industry practice group.

His corporate practice is diverse, focusing on mergers and acquisitions and corporate and commercial transactions in general, including mergers, spin-offs, strategic alliances and IT transactions, both domestic and transnational, with emphasis on the consumer goods, energy and technology sectors.

His clients include public companies on the Dow Jones, S&P, DAX, Nikkei and BMV indexes, some of the most profitable Forbes 100 Top Brands, and some of the largest and most innovative private capital and risk capital funds. He has performed a key role in some of the most innovative and complex M&A matters and transactions taking place recently in Mexico and Latin America.

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Juan Pablo Caicedo De Castro is a senior associate at Gómez-Pinzón. He works in the corporate/mergers and acquisitions, banking, finance and capital markets, and infrastructure practice areas. He holds a law degree from the Pontifical Javierian University, a postgraduate degree in international business law from the University of the Andes and a master's degree in international economic law and policy from the University of Barcelona. In addition to his experience at Gómez-Pinzón, he has worked as legal director for corporate affairs at the major Colombian construction company Amarilo, as an associate at Brigard & Urrutia and as a legal intern at the legal affairs division of the World Trade Organization in Geneva.

He has considerable experience in commercial and financial law matters, contracts, complex M&A transactions, projects, joint ventures, capital markets operations, privatisations and transactions with public entities. He has advised institutional and financial investors in the acquisition of infrastructure and energy projects and strategic investors on the implementation of joint ventures and collaboration schemes, and he has assisted public entities and state-owned companies in the design, structuring and execution of privatisations, including operations in the Colombian Stock Exchange. His practice focuses on the infrastructure, energy, public utilities, real estate, telecommunications and financial services sectors.

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Giancarlo Carrazza is an associate in D'Empaire's arbitration, corporate and M&A practice groups. His practice is focused on advising domestic and international clients on mergers and acquisitions and general corporate matters in a range of industries that includes manufacturing, insurance and financial services. Giancarlo also has experience representing clients in domestic and international arbitrations, including commercial and investor-state disputes under the ICSID, UNCITRAL and ICC rules. He received a JD *summa cum laude* from Andrés Bello Catholic University in 2018.

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Roberto Carrillo is a director in the firm's corporate law practice, where he focuses on M&A, financial regulation, capital markets and corporation law.

His practice centres on providing counsel to both Chilean and international clients, including private equity funds and a wide range of financial institutions, in their transactions and investments within the Chilean market. He provides guidance and advice on cross-border M&A transactions and project financing, to bondholders on their interests in Chile and on securities law matters. Roberto has also assisted clients in structuring the acquisition and financing of their transactions, including for post-closing reorganisation of holding companies. Beyond transactional support, he provides ongoing legal counsel for the day-to-day operations of companies based in Chile.

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Alberto Córdoba is a partner at Von Wobeser y Sierra, with more than 15 years of experience in M&A, corporate matters and transactions in various industries, including oil and gas, energy, the media, heavy and light manufacturing, retail and private capital. He is a member of the corporate and mergers and acquisitions practices and of the Energy Industry Group.

His practice focuses primarily on mergers and acquisitions and corporate matters. His experience includes mergers, asset transfers, strategic alliances and joint ventures, both national and transnational.

Within the mergers and acquisitions practice, he regularly advises large national and multinational companies and global private capital investors in acquisitions and investments in various industries in Mexico.

In the energy sector, his experience includes numerous transactions, both public and private, including projects launched by the productive companies of the state, Pemex and the Federal Electricity Commission.

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Iván Delgado is a partner at Pérez-Llorca. After establishing and leading the firm's New York office, he rejoined the Madrid office in 2021, where he advises on complex transactions and matters. He combines this with his responsibilities in the firm's international practice as head of the Latin American desk. Mr Delgado has more than 20 years of experience and specialises in M&A of listed and unlisted companies, venture capital operations and general corporate and commercial matters. He also advises industrial groups on prominent cross-border transactions in diverse sectors. Mr Delgado's focus on advising Latin American clients has provided him with the opportunity to be involved in some of the most significant transactions in the Spanish market. He was previously an associate professor of corporate law at University Charles III and the IE Business School in Madrid.

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Raúl Fernández-Briseño is a partner in the corporate and securities practice, based in the firm's Mexico City office. He is a leading transactional and experienced M&A and finance lawyer with particular knowledge in the infrastructure, telecoms, private equity, fintech and restructuring sectors. He focuses on acquisitions, shareholders' arrangements, cross-border transactions and corporate disputes. In addition, he regularly handles complex structured financings and regulatory issues in several industries, particularly in the telecoms and transportation industries. His experience also covers equipment financing (such as shipping and aircraft), real estate, regulatory issues in the telecoms, satellite, maritime and railway industries, and project finance-related matters. Raúl has recently advised clients in the fintech space, mainly involving e-commerce, apparel retail and real estate.

Raúl has developed a strong track record in M&A, financing and restructuring matters across a wide range of industries.

In 2016, Raúl was named in *Expansión* magazine's list of '30 Promises (for a Challenging Year)', recognising young professionals that provide innovative solutions to daily challenges.

Prior to joining Mayer Brown, Raúl spent almost 20 years at a prominent international law firm. He holds an LLM from McGill University in Montreal, Canada, and he has been a commercial law professor at the Autonomous Technological Institute of Mexico for over a decade.

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Over the years, Mr Furci has built a reputation as a creative and commercial problem solver. He is listed as a leading tax lawyer in *Chambers Global* and *Chambers USA*, where clients have described him as 'extremely smart' and 'collaborative, creative and technically excellent', 'with a solid base of experience in deals and a good sense of market trends'. Clients have also noted that he 'consistently produces high-quality work and is very responsive' and that he is 'a phenomenal tax lawyer who is practical and solution-oriented'. Mr Furci is recognised in *The Legal 500: US*, where sources have noted that he is 'outstanding, proactive and thoughtful' and 'simply the best tax lawyer I have ever worked with'.

A frequent writer and speaker on tax and private equity, Mr Furci is an adjunct professor of tax law at New York University Law School and serves on the executive committee of the New York State Bar Association tax section.

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Francisco Javier Garibay Güémez is a senior associate in Mayer Brown's Mexico City office. He is a member of the banking and finance practice, where he is active in M&A and general corporate matters. Javier joined Mayer Brown in May 2018. He has represented both Mexican and international purchasers and sellers in stock and assets acquisitions and joint ventures. His experience includes complex M&A deals, as well as corporate governance compliance, for both public and private companies.

Javier also has experience in handling disputes among shareholders, companies and senior executives. His experience in this field includes bankruptcy and insolvency matters, in which he has represented major creditors, debtors and strategic and financial investors, as well as governmental entities.

Javier has also worked on a pro bono basis for several non-profit organisations.

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Hans Peter Goebel Caviedes is an internationally recognised leading attorney and founding partner at Nader, Hayaux & Goebel. His main areas of practice are banking and finance, M&A, private equity, capital markets, real estate, and general corporate and commercial law. Hans has a strong background in banking law and regulations, and he handles a variety of financial, capital markets and corporate governance matters. He is an expert in complex structured finance deals and security issuances, as well as in local and cross-border M&A and private equity transactions.

Hans frequently acts as a trusted adviser to boards and board committees, shareholders and individuals on critical corporate governance issues and shareholder disputes. He graduated as an attorney at law from the Mexico Autonomous Institute of Technology and has a Master of Laws (with honours) from Northwestern University of Chicago. He was previously a foreign associate at Mayer Brown LLP in Chicago and a professor of financial contracts at the Ibero-American University in Mexico City.

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Ricardo Güell is a partner at Deloitte Legal in Costa Rica. He specialises in commercial and corporate matters, mergers and acquisitions, corporate restructuring and financing transactions. He also leads the Nicaragua and Honduras legal practices.

He has more than 19 years of experience in all areas of Costa Rican commercial and corporate law. He advises clients investing in Costa Rica and assists Costa Rican companies in structuring their businesses.

Ricardo has an LLM from Tulane University. He has a degree in notarial law from Fidelitas University and a degree in law from the University of Costa Rica.

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Daniel Hernández is an associate at Skadden, Arps, Slate, Meagher & Flom LLP. He represents multinational corporations, institutional and financial investors, family offices and other privately held companies in mergers, acquisitions, joint ventures, private equity and venture capital transactions, as well as other complex corporate transactions, concentrating in cross-border M&A throughout Latin America.

He has more than 11 years of experience in cross-border M&A transactions involving Latin American parties, targets and assets while based in New York, Brazil and Colombia. Daniel has an LLM degree from Harvard Law School and graduated first in his JD class from Del Rosario University (Colombia).

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Fulvio Italiani is considered one of the leading M&A and corporate lawyers in Venezuela. He has participated in most of the significant acquisition, financing and oil and gas transactions to take place in Venezuela in the past. Fulvio has been consistently named as a star individual for M&A and corporate in *Chambers Latin America*. He was honoured with an award for 'Outstanding Contribution to the Legal Profession' at the 2013 Chambers Latin America Awards for Excellence. Before becoming a partner at D'Empaire in 1997, Fulvio worked as an associate at the New York offices of Skadden, Arps, Slate, Meagher & Flom from 1993 to 1996. He received a JD *summa cum laude* from Andrés Bello Catholic University in 1990.

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José Francisco Iturrizaga is a partner at Deloitte Legal in Peru. He has experience in corporate law and finance, as well as in other corporate operations. He has advised local and international clients on corporate advisory and has led several M&A transactions, financings, and private equity and corporate operations. His professional career includes participation in the most prestigious international specialised publications.

In the academic field, he has served as a professor at the Pontifical Catholic University of Peru and the National University of San Marcos. José joined the firm in February 2022.

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Elías Jalife is an associate at Von Wobeser y Sierra. He participates in the corporate, M&A, banking and finance, and telecommunications, media and technology areas. He has extensive experience in different aspects related to corporate and commercial transactions and with transactions related to aspects of information technology and telecommunications, in which he has been directly involved during the stages of negotiation, document drafting and closing.

Elías also has broad experience in the review, drafting and negotiation of civil, commercial and IT contracts. In the firm, Elías has advised companies on general legal matters in relation to compliance with their corporate, regulatory and financial obligations. Elías has also advised companies whose primary purpose consists of the production and marketing of consumer goods, and therefore he actively participates in the Consumer Industry Group.

Maurizio Levi-Minzi
Debevoise & Plimpton LLP

Maurizio Levi-Minzi is an M&A partner at Debevoise & Plimpton, with 30 years of experience advising clients on cross-border acquisitions of a broad variety of assets, including infrastructure assets, and complex joint ventures. He is co-head of the firm's Latin America practice. Mr Levi-Minzi has led transactions in Latin America, the United States, Europe and Asia for private equity groups and strategic investors, including Ambev, Barrick, Brookfield, BTG Pactual, Carlyle Group, Clessidra, CPPIB, CSN, GP Investments, HIG and Mitsui.

He is ranked as a leading lawyer for M&A in Latin America by *Chambers Global* (2023), *Chambers Latin America* (2024), *Latin Lawyer 250* (2023) and *The Legal 500: Latin America* (2023). Mr Levi-Minzi is also recognised as a leading M&A lawyer by *IFLR1000* (2022) and has been named an 'Expert in Mining' by *Who's Who Legal* (2022).

Mr Levi-Minzi is frequently invited to speak on trends related to cross-border private equity and M&A transactions involving Latin America. He is an adjunct professor at New York University, where he teaches cross-border M&A, and at Fordham Law School, where he teaches corporate practice. In 2022, he also co-taught cross-border M&A as a visiting professor at the University of São Paulo.

Mr Levi-Minzi is fluent in Italian and Spanish and understands Portuguese.

Andrew M Levine
Debevoise & Plimpton LLP

Andrew Levine is a litigation partner at Debevoise & Plimpton, a member of the firm's white collar and regulatory defence group and co-head of its Latin America practice. He is well recognised in the region and elsewhere for defending companies and individuals in criminal, civil and regulatory enforcement matters and for conducting internal investigations. Mr Levine has represented many clients on corruption-related matters in Latin America, including the Lava Jato, Zelotes, Carne Fraca and FIFA scandals. He has led important representations in Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Guatemala, Mexico, Peru, Uruguay and Venezuela, among other countries. In addition to an active defence and investigations practice, Mr Levine frequently advises clients on a broad array of compliance and ESG matters, including assessing and mitigating risks presented by potential corporate transactions. His practice also encompasses complex litigation and other commercial disputes.

Mr Levine is ranked as one of the two top lawyers for corporate crime and investigations in Latin America by *Chambers Latin America* and as a leading lawyer for FCPA by *Chambers USA*. Clients in these directories have described him as 'a massive name in the region for this kind of work', 'a leading expert in providing sophisticated compliance advice to large multinationals' and 'a reassuring presence in tumultuous times' with 'a very business-oriented way of finding and presenting solutions'.

In 2020, Latin Lawyer named Mr Levine as 'International Lawyer of the Year', based on 'his profile in the market and the vast amount of work he has done to shape the development of anti-corruption and investigations work in Latin America'. Since 2013, Mr Levine has co-chaired annually 'Latin Lawyer and GIR Live Anti-Corruption & Investigations Brazil' and, since 2019, the edition of this conference in Mexico.

Paola Lozano

Skadden, Arps, Slate, Meagher & Flom LLP

Paola Lozano is a New York-based M&A partner at Skadden, Arps, Slate, Meagher & Flom LLP. She is the co-chair of Skadden's Latin America Group and the head of the firm's Spanish language corporate practice. She has also served as a member of Skadden's Policy Committee.

Paola has been repeatedly recognised by her clients and colleagues. Among others, she was Latin Lawyer's '2019 International Lawyer of the Year', a *New York Law Journal* '2019 Distinguished Leader' and one of Crain's 'New York Business Notable Women in Law 2019'. She is ranked as Band 1 for corporate M&A in Latin America by Chambers (the first and only woman to achieve that ranking) and is also included as a top attorney in Lawdragon 500 Leading Lawyers in America (2014–2023); Latinvex Latin America's Top 100 Lawyers (2014–2023) and Latinvex Latin America Top 50 and Top 100 Female Lawyers (2013–2023).

Her M&A practice focuses on cross-border transactions throughout the Americas and globally, including mergers, acquisitions, dispositions, joint ventures, private equity and venture capital transactions, as well as other complex corporate matters. Her clients include Fortune 500 companies, multinationals, multilatinas, private equity and venture capital funds, family offices and other privately held companies.

She is admitted to practise in New York and Colombia.

Pablo Mijares

Mijares, Angoitia, Cortés y Fuentes

Pablo Mijares 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 and 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.

Lao Olmos

Bruchou & Funes de Rioja

Lao Olmos is a partner in the general corporate and M&A department of the firm. He is also co-head of the firm's antitrust department. His practice focuses on M&A and divestitures, involving both public and private companies.

Mr Olmos regularly represents acquirers, targets, boards of directors, investors and shareholder groups in complex domestic and international M&A transactions.

He has a law degree, with honours, from the Law School of the Catholic University of Argentina and an LLM from the Columbia University School of Law.

Ralph E Pérez

Skadden, Arps, Slate, Meagher & Flom LLP

Ralph E Pérez is a counsel in Skadden, Arps, Slate, Meagher & Flom LLP's M&A practice. He advises clients on a broad range of securities and corporate matters, including mergers, acquisitions, dispositions and joint ventures. He has been recognised by the Hispanic National Bar Association as a 'Top Lawyer Under 40' (2020) and by Latinvex as a 'Rising Legal Star' (2018).

Ralph is a former certified public accountant and practised at Deloitte prior to attending the University of Chicago Law School. He went to New York University as an undergraduate. He is admitted to practise in Illinois and New York.

Joaquin Perez Alati

SoftBank Investment Advisers

Joaquin Perez Alati is a director, Senior Counsel, at SoftBank Investment Advisers, the manager of the SoftBank Vision Funds and SoftBank Latin America Funds, where he leads the structuring and negotiation of cross-border transactions, including M&A, equity investments and divestments in the United States, Latin America and Europe. Beyond the transactional work, he oversees legal matters for a portfolio of investments across different jurisdications.

Prior to joining SoftBank, Mr Perez Alati was an associate at Sullivan & Cromwell LLP, where he worked on M&A, capital markets, project finance and restructuring matters, representing local and international corporations, sovereign states and investment banks. Prior to this, he was an associate at Pérez Alati, Grondona, Benites & Arntsen, where he represented local and international corporations and investment banks in cross-border M&A, capital markets, financings and restructuring transactions.

Mr Perez Alati has a law degree (with honours) from the University of Buenos Aires and a Master of Laws (LLM) from Columbia University, where he was a recipient of the Harlan Fiske Stone award.

Carlos Rodolfo Ríos Armillas

Nader, Hayaux & Goebel

Carlos Rodolfo Ríos Armillas is an associate at Nader, Hayaux & Goebel. His main areas of practice are capital markets, banking and finance, M&A and general corporate matters. Carlos has been involved in a variety of complex and large financial, capital markets and corporate matters, representing local and foreign public and private companies, investors, banks and financial entities in various local and cross-border transactions, including securities offerings in Mexico and abroad, financings, debt restructurings, M&A and shareholder disputes, as well as in securities and financial regulatory matters. Carlos graduated as an attorney at law (with the highest honours) from the Free University Law School.

Jaime Robledo Vásquez
Brigard Urrutia

Jaime Robledo Vásquez is co-head of the corporate/M&A team at Brigard Urrutia. He has more than 25 years of experience advising clients on a wide range of areas, including share and asset purchases, M&A, joint ventures and share subscriptions. He is also recognised as a strategic adviser to boards of directors and C-suites of private, public and state-owned entities. Mr Robledo has worked in M&A in a wide array of industries and has specialised in complex transactions as well as strategic advisories, including dealing with activist shareholders and successfully defending listed companies from hostile takeovers. He has extensive experience in advising different types of clients, including strategic investors, private equity funds, family offices, institutional investors and sovereign funds in all types of transactions.

Eduardo Rojas Brandao
Mayer Brown Mexico, SC

Eduardo Rojas Brandao assists national and international investors and funds with complex, high-value cross-border transactions within Mexico and the US, including multinational joint ventures and primary and secondary sales and acquisitions. He also represents clients, including borrowers, banks and financial institutions, in transborder secured and unsecured financings to Mexican and Latin American companies.

Clients rely on Eduardo for his deep understanding of the regulatory and legal landscape in Mexico. He counsels clients in diverse sectors such as energy, infrastructure, banking and finance, spirits, agribusiness and foreign investment. He also advises clients in their decisions to commence operations in Mexico. Eduardo speaks fluent Spanish, English and Portuguese.

Giselle C Sardiñas
Morrison & Foerster LLP

Giselle C Sardiñas is an associate in the Miami office of Morrison & Foerster LLP and is a member of the firm's finance department.

Mariana Seixas
SoftBank Investment Advisers

Mariana Seixas is a director, Senior Counsel, at SoftBank Investment Advisers, the manager of the SoftBank Vision Funds and SoftBank Latin America Funds, where she leads structuring and negotiations for cross-border transactions, including investments, divestments and M&A. She works closely with the legal teams of the Funds' portfolio companies on portfolio management as well as managing other fund activities. She brings more than 10 years of legal experience from leading corporate transactions across Latin America, representing local and multinational corporations, sovereign entities and investment banks. Prior to joining SoftBank, Ms Seixas was a senior associate at White & Case LLP, where she worked in the firm's Miami and São Paulo offices on capital markets, project finance and other strategic corporate transactions. Mariana has a BA from the University of Virginia and a JD from the University of Virginia School of Law, where she was executive editor of the *Virginia Law Review*.

Luciana Tornovsky
Demarest Advogados

Luciana Tornovsky is a senior partner at Demarest Advogados, based in São Paulo, Brazil. She focuses on M&A, corporate, private equity and venture capital. She is widely experienced in cross-border and domestic M&A transactions, representing Brazilian and international clients in numerous sectors, such as the chemical, pharmaceutical, health, automotive and technology industries. Ms Tornovsky has advised in highly complex transactions involving the purchase and sale of companies, M&A, joint ventures and corporate reorganisations. She obtained an LLM and an international tax programme postgraduate degree from Harvard University.

Sergio Torres
Debevoise & Plimpton LLP

Sergio Torres is a corporate counsel and a member of the firm's M&A, private equity and Latin America groups, with 15 years of experience practising in both Brazil and the United States. His practice focuses on domestic and cross-border acquisitions, divestitures, complex joint ventures, venture capital and private equity investments, and corporate governance matters for private equity sponsors, financial institutions and other corporate clients.

He is ranked as an 'up-and-comer' by *The Legal 500: Latin America* (2023). In 2022, he co-authored the preface of *Fusões e Aquisições: Pareceres* (*Mergers and Acquisitions: Legal Opinions*), a collection of legal opinions rendered by Brazilian legal scholars in M&A arbitration disputes in Brazil.

Mr Torres is an adjunct professor at Fordham Law School, where he teaches contract drafting and negotiation.

Mr Torres is fluent in Portuguese and proficient in Spanish.

Patricio Trad

Mijares, Angoitia, Cortés y Fuentes

Patricio Trad appears in the main list of M&A leaders and is considered as a corporate finance all-rounder with broad experience in corporate transactions and structured finance matters. He has vast experience in mergers and acquisitions, buyouts, joint ventures and divestitures.

He is also a relevant practitioner in capital markets and energy practice areas.

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 oil and gas, electricity and other 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.

Lina Uribe García

Gómez-Pinzón

Lina Uribe García leads the corporate/mergers and acquisitions practice of Gómez-Pinzón. She has a law degree from the Pontifical Javierian University and a Master of Laws in energy and environment with distinction from Tulane University.

She has more than 24 years of experience in mergers and acquisitions, private equity, joint ventures and corporate matters. Lina also has broad experience in local and cross-border corporate reorganisations, along with operations such as mergers, spin-offs and conversions – experience that was amassed in her many years in the M&A and corporate practice. She has counselled national and foreign sellers and buyers, including private equity funds, in acquisition procedures, from the legal due diligence stage, the structuring, preparing and negotiation of documents, the request of approvals to governmental authorisations, up to the closing and post-closing of the transaction.

Additionally, as part of the energy and natural resources practice group, she is responsible for the environmental section and is an expert in environmental legislation, regulations and policies in connection with settlements, litigation and compliance with regulatory issues.

Daniel Villa

Morrison & Foerster LLP

Daniel Villa was a 2023 summer associate in the Miami office of Morrison & Foerster LLP.

Isabela Martins Xavier

Araújo e Policastro Advogados

Isabela Martins Xavier is a partner in the corporate and M&A practice at Araújo e Policastro Advogados. She has a master's degree (LLM) from the University of Chicago Law School and a bachelor's degree in law (equivalent to a JD) from the University of São Paulo Faculty of Law. She has more than 20 years of experience in the areas of corporate law, international contracts, civil consulting and administrative law.

Isabela has participated in numerous national and international transactions. She is recommended in *Latin Lawyer 250* and is recognised in the corporate, contracts, hotel business and tourism areas in the state of São Paulo in *Análise Advocacia 2021* and in *Análise Advocacia Mulher 2022*. She is a member of the São Paulo Chapter of the Brazilian Bar Association and of the New York State Bar Association.

APPENDIX 2

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