El Salvador

Negotiated M&A Guide 2022

Corporate and M&A Law Committee

Contacts

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1. INTRODUCTION

This guide provides an overview of the law and practice dealing with private M&A transactions in El Salvador. This guide does not constitute legal advice. Anyone involved in private M&A transactions should seek specialist advice.

2. APPLICABLE LEGISLATION

M&A transactions in the Republic of El Salvador are governed by the following Salvadoran laws and regulations.

2.1 Constitution

Based on the liberty of contract granted by the Salvadoran Constitution, parties may enter into merger or acquisition transactions and may determine the law and jurisdiction that shall govern it. Salvadoran law will govern the formalities and requirements for perfecting the transfer of Salvadoran stocks or assets.

Article 110 of the Constitution expressly prohibits monopolies, except for those granted in favour of the state or the municipalities, and only when public interest demands it. Additionally, this article also sets the basis for regulating and enforcing antitrust statutes as follows: ‘in order to guarantee economic freedom and consumers, monopolistic practices are prohibited’. It is clear that the Constitution does not punish a monopolistic position per se, but only punishes the abuse of such position.

2.2 Commercial Code

Business entities are regulated in El Salvador under the Commercial Code *(*Código de Comercio*)*. It generally grants the parties with enough freedom to agree on many issues of corporate structure and governance. The Code also regulates mergers, and its effects on shareholders and creditors.

2.3 Civil Code

The rules contained in the Civil Code supplement those in the Commercial Code and regulate more formal aspects of a transaction, such as formalities, capacity and contractual rules.

2.4 Tax Code and its regulation

The Tax Code contains the main and general tax obligations of corporations and companies in El Salvador. The Tax Code is complemented by its own regulations and other special laws, such as the Income Tax Law, Value Added Tax Law and the Real Estate Transfer Tax Law.

The Salvadorean tax system is based on the territorial principle. Therefore, income derived from the following is subject to income tax:

(a) movable and immovable property in El Salvador
(b) activities carried out in El Salvador
(c) services rendered by non-domiciled entities which are used or availed of in El Salvador

Capital gains derived from the sale of movable and immovable property are subject to income tax. This includes stocks or shares in companies, to which the Income Tax Law establishes a special regime. Capital gains derived from transfers of real estate are taxable under the rules applicable to capital gains.

The VAT rate is currently 13 per cent and applies to the provision of services and the sale of goods. This may also apply to a transaction that is configured as an asset deal. Capital assets (applicable only to movable property) that are under four years of acquisition will be subject to VAT. Further, the inventories will be subject to VAT. In this case, the time of the acquisition of the inventories is irrelevant.

2.5 Real Estate Transfer Tax Law

There is also a real estate transfer tax which exempts transactions with a value up to SVC 250,000 (US$28,571), and taxes at a flat rate of 3 per cent of any transaction amount exceeding that threshold.

2.6 Labour Code

The Labour Code regulates the relationships between workers and employers. The major areas of regulation are:

(a) individual labour rights, such as conditions of employment, contracts, the enforcement of wage, working hours, benefit laws, personnel management, and employment termination and dismissal;
(b) collective bargaining rights and industrial relations;
(c) the administration and application of social and workplace benefits; and
(d) labour inspections.

Constitutionally recognised rights included in the Labour Code are:

(a) freedom to enter into collective bargaining agreements;
(b) freedom to associate, create labour unions and the right to strike; and
(c) workers' inability to waive any of their rights.

Whenever an employer substitution pursuant to an M&A transaction takes place, the existing labour agreement does not end and the new employer is jointly liable with the former employer for those obligations that arose before the substitution. This shared responsibility is for a period of 60 days following the substitution. After that period, the new employer is the only party responsible for any labour liabilities. The Labour Code establishes that an 'employer substitution' is not a cause for termination of labour agreements, nor does it adversely affect the rights of an employee.

In cases of occupational hazards, retirement and other similar situations in which the original employer had obligated itself, by will or by law, all the obligations payable in the form of pension shall be the responsibility of the new employer and it will be bound to make the applicable payments from the time of the substitution.

Article 609 of the Salvadoran Labour Code also states that labour court cases and disputes pending against the previous employer will be assumed by the new employer, whether or not the new employer was part of the original dispute.

The law says nothing about the document or agreement that the parties should sign for the 'employer substitution'. Nevertheless, it is advisable, when the transaction is structured as an assets transfer deal which entails the transfer of employees, to elaborate an agreement for the 'employer substitution', which must be submitted to the General Office for Labour Inspections.

2.7 Administrative Procedures Law

The Administrative Procedures Law (APL) entered into force on 13 February 2019. It regulates the formalities and principles that the Public Administration must follow in its proceedings. Among the principles that the APL includes are legality, proportionality, efficiency, economy, good faith, etc. In addition, it expressly regulates the rights of the parties in an administrative proceeding, such as the use of electronic means to communicate with governmental entities, privacy and confidentiality of personal data, access to information contained in public records, etc.

This new regulation is relevant in an M&A context since, depending on each case and transaction, there are certain matters that may be related to administrative procedures before governmental authorities. These may include request of authorisations of regulated companies, antitrust clearance under the Competition Law, change of ownership of assets, etc.

2.8 Competition Law and its regulation

The Competition Law (CL) came into effect on 1 January 2006. Since then, the legal and transactional landscape of El Salvador has been changed because of the broad definitions contained in the CL regarding the subject matter jurisdiction of the Competition Superintendence (CS) and the cases that have to be filed before the CS. An amendment to the CL was passed on 17 November 2021 to harmonise it with the APL, since prior to such regulation both the CS and the administered parties themselves had to interpret and integrate the competition law based on the regulation and administrative procedures established in the APL. With this amendments, greater legal certainty is expected with the application of the CL.

Conceptually speaking, the CL focuses more on anticompetitive behaviours than on market structures and views mergers with a preventive focus. The CL does not punish market share or dominant positions, but attempts to avoid abuse of dominant positions. The CL regulates all economic agents, a term that is defined in the law as 'any natural or legal person, public or private, engaged directly or indirectly in a lucrative or non-lucrative economic activity'.

The CL dedicates a chapter to the issue of 'economic concentrations': that is, mergers that substantially may have an impact in the competition or tend to create monopolies in either a product market or a geographic market. In order to determine whether there is a concentration, the law establishes a two-tier test, the operative part of the first tier of the test is as follows:

> 'When economic agents that have been independent from each other perform, among others, acts, contracts, agreements, arrangements, with the purpose of merging, acquiring, consolidating, integrating or combining their businesses in whole or in part'

And:

> 'When one or more economic agents that already control at least another economic agent acquires by any means the direct or indirect control in whole or in part of more economic agents.'

The second tier of the test is a quantitative examination and it will determine whether the 'combined total assets exceed 50,000 minimum yearly salaries or combined total revenue exceeds 60,000 minimum yearly salaries'. For purposes of the CL, control is defined as:

> 'The capacity of an economic agent to influence another through the exercise of property or use rights, of all or part of the assets of the economic agent or through agreements that confer substantial influence in the composition, voting or resolutions of the management or administrative bodies, administrator or legal representatives of the economic agent.'

Authorisation from the CS is required if the combined total assets of the economic agents exceed 50,000 minimum urban annual wages in the industry sector (US$219m) or their total income exceeds 60,000 minimum urban annual wages in the industry sector (US$262.8m).

In that case, the interested economic agents shall file a written application before the CS indicating the names of the parties involved and the type of transaction that they want to carry out, accompanied by the financial statements of the last fiscal year of the agents involved and any other relevant data of the transaction expressly indicated in the CL.

The CS has 90 business days to approve or deny concentration requests, which cannot be rejected if the interested party proves the following: (1) the operation will result in significant advantages that will reduce costs and will produce direct benefits to consumers; (2) it cannot be obtained by other means; and (3) market supply will be not reduced.

2.9 Intellectual Property Law and its regulation

The laws and regulations regarding intellectual property regulate all issues concerning trademarks, copyrights, related rights, patents and industrial designs.

2.10 Securities Market Law

If there is a public offer for the acquisition/transfer of shares, the Securities Market Law must be complied with. The procedure will be supervised by the Financial System Superintendence (FSS).

2.11 Other regulation

If the companies are subject to specific regulation, other regulation should be examined depending on the nature of the companies involved (such as banks or insurance companies). In these cases, the FSS also supervises the procedure that must be followed to obtain specific authorisations for the acquisition.

If at least one of the companies operates in El Salvador as a pension fund administrator, the Pension Savings System Law must be complied with. The FSS is the authority in charge of its supervision.

Companies in the energy and telecommunications sectors are also separately regulated in El Salvador. In these cases, the Electric and Telecommunications Superintendence (SIGET) may supervise the procedure according to the Electric Law and the Telecommunications Law.

3 STRUCTURE OF THE TRANSACTION

The acquisition of a business may be structured in a variety of ways under an asset sale or a stock purchase deal. Such structure will depend on what the buyer is aiming to achieve and, in some cases, on the corporate structure of the seller.

If the buyer is only interested in one part of the business of the seller, not in its entire business, then an asset deal will probably be the best option. On the other hand, a share deal is generally recommended for a buyer who intends to acquire the entire operation of the seller (ie regional operations).

Asset deals are regulated by the civil laws and they usually involve the purchase of fixed assets (ie real property, machinery, etc.). The transfer of intellectual property is regulated by the Intellectual Property Law. Share deals are regulated by commercial laws and involve the acquisition of all assets, intellectual property rights, liabilities and other elements of the seller.

Most share deals take place at the level of a holding company, usually incorporated in foreign countries. This may involve retaining counsel based in such foreign jurisdictions, in addition to local counsel, to perform due diligence on both the holding and operating companies.

3.1 Due diligence

Salvadoran law does not establish particular requirements for a merger or acquisition, therefore the parties may determine the information that will be disclosed in the due diligence exercise. The minimum recommended information that should be required for a Salvadoran target includes:

(a) corporate structure and relationship between the holding company, affiliates, subsidiaries and/or joint ventures;
(b) internal rules;
(c) corporate and accounting records;
(d) shareholding structure;
(e) any agreement that could limit or prevent the transfer of shares, such as shareholders' agreements;
(f) financial statements and other relevant financial documents;
(g) listing of assets;
(h) contracts and liaisons which may be inter-company and/or with third parties;
(i) all licences and permits granted by government institutions and required for the company's operation, particularly those granted by regulatory entities;
(j) a certificate of good standing for fiscal and municipal taxes;
(k) labour agreements, union situation and/or a certificate of good standing before the social security authority and pension funds;
(l) environmental practices and permits; and
(m) judiciary administrative and non-judiciary proceedings, both concluded or pending for final resolution.

4 PRE-AGREEMENT

4.1 Letter of intent

There is no regulation in El Salvador regarding the enforceability of a letter of intent (LOI). The Commercial Code establishes that a contract may be constructed by an offer and an acceptance and obligations will arise from such acts. Nonetheless, usually, LOIs are not binding on the parties in their entirety, especially when the LOI constitutes only the intent of the parties and is not signed by the parties.

However, some provisions such as non-disclosure agreements, 'stand-still' or 'no-shop' provisions entitling exclusive rights to negotiate may be enforceable. Normally, in this case, the LoI will be executed by both parties and in some cases, is referred to more often as a Memorandum of Understanding (MOU).

Therefore, it is always advisable to include in an LOI or an MOU a clause that determines the law and jurisdiction that shall govern all the situations and disputes between the parties that may arise from this document.

4.2 Procedure and requirements for a merger

Each Salvadoran company must approve the merger in an extraordinary shareholders' meeting, the minutes of which are registered at the Registry of Commerce. The extraordinary shareholders' meeting shall be held pursuant to the following rules (unless the by-laws of the company establish additional requirements):

(a) The quorum required on first call (ie, on the first date stated in the notice of the meeting) is 75 per cent of the capita stock. The resolutions must be passed at the shareholders' meeting by the favourable vote of the shareholders representing 75 per cent of the share capital of the company.
(b) The quorum required on second call (ie on the second date stated in the notice of the meeting) is 50 per cent plus one of the paid-in capital. The resolutions must be passed at the shareholders' meeting by the favourable vote of shareholders representing 75 per cent of the share capital of the company.
(c) If the meeting cannot be held for lack of a quorum in the first and second calls, a third notice shall be made. A shareholders' meeting held on the third call will be valid, regardless of the representation of the share capital of the company and number of shareholders present, and resolutions will be passed by a simple majority vote (ie, 50 per cent plus one) of the shares being represented in the meeting.
(d) In shareholders' meetings held to approve a merger, all the shares will have a right to vote, including the shares with limited or restricted voting rights.
(e) The articles of incorporation of a company may increase the minimum attendance and voting quorum requirements. However, parties may not reduce these requirements through the articles of incorporation.

The merger process follows these steps: once the merger has been approved at the shareholders' meeting, the articles of incorporation of the new company or the necessary amendments to the bylaws of the acquiring company shall be drafted and approved in an extraordinary shareholders' meeting for each of the companies. Before registering the merger agreement at the Registry of Commerce, the filing party must obtain the certificate of good standing or the non-taxpayer certificate, which are issued by the Ministry of Finance (Ministerio de Hacienda).

Once the merger agreement is recorded before the Registry of Commerce, it shall be published together with the last balance sheet for the companies in the Official Gazette and in two Salvadoran newspapers on three alternate occasions. The public deed of the merger bay be granted after a period of 90 days after the date of the last such publication, provided no legal challenge has been filed by a third party.

Any interested party may file a judicial action to oppose the merger within the aforementioned 90-day period. Interested parties may include dissenting shareholders or creditors. Every shareholder, including those with limited or restricted voting rights, can bring an action to object to the resolutions passed by the shareholders meeting, including the decision to merge the company, provided that the following conditions are met: (1) that the merger resolution involves a violation of the law or of the articles of incorporation of the company; and (2) that the resolution does not involve the liability of the managers or the auditors of the company. Further, a merger may not negatively affect minority shareholders' rights.

The shareholders of the merged companies may receive stock in the new or acquiring company in a proportion equal to the amount they held prior to the merger, unless otherwise provided for in the merger agreement.

If there is no objection from a third party, the public deed of the merger may be granted and filed before the Registry of Commerce for its registration. In practice, a parallel procedure must be followed before the CS to obtain the antitrust clearance of the merger before being registered.

4.3 Minority and dissenting shareholders' rights

Minority shareholders' rights may be set forth in the articles of incorporation; however, the law already includes minority shareholders' rights. Shareholders who do not agree with a merger (ie, 'dissenting' shareholders) may withdraw from the company by exercising their appraisal rights. Salvadoran law does not establish the right for dissenting shareholders to be bought out by other shareholders. Nevertheless, they may exercise appraisal rights over their capital participation in the corporation.

If a dissenting shareholder decides to withdraw, such appraisal rights shall be exercised within the period of 90 days of the date of publication of the merger agreement in the newspapers. The shareholders may not exercise such appraisal rights if, as consequence of the withdrawal, the capital of the company falls below the minimum permitted by law. The value paid by the corporation to the dissenting shareholder for each share shall be the result of dividing the book value of the shareholders' equity by the number of shares in circulation, all according to the last balance sheet approved by the general shareholders' meeting.

5 ACQUISITION AGREEMENT

The acquisition agreement in international transactions is generally governed by foreign law; however, the parties may freely decide to apply Salvadoran laws. This is particularly true in share deals where, as mentioned above, the acquisition usually takes place at the holding company level. The choice of foreign governing law is mainly due to the lack of sophistication of Salvadoran laws compared to the laws of other jurisdictions, and also to submit any conflict from the acquisition agreement to foreign courts, usually to foreign arbitration rules.

5.1 Representations and warranties

The seller and the buyer usually include mutual representations and warranties in the acquisition agreement. The seller's representations and warranties will typically constitute the largest section of the acquisition agreement, together with the indemnity rules which are directly related to the representation and warranties. As a result of the buyer's due diligence, it will enable the buyer to learn as much as possible about the seller's business. Additionally, the seller's representations and warranties provide a mechanism of protection for the buyer, enabling it to walk away from, or renegotiate the terms of, the acquisition if the buyer discovers facts that are contrary to the representations and warranties between signing and closing/post-closing. Furthermore, the seller's representations and warranties provide the framework for the seller's indemnification obligations to the buyer after the closing.

From the seller's perspective, if the buyer is paying the purchase price in cash at the closing, the most important representations and warranties the seller can obtain from the buyer are those governing the buyer's corporate authorisation and financial condition (ie, the buyer's ability to pay the purchase price). If the buyer is paying the purchase price over time or by issuing stock, the seller will require more extensive representations and warranties from the buyer.

Representations and warranties in acquisition agreements of Salvadoran entities usually involve:

(a) the seller's and buyer's corporate organisation and capitalisation;
(b) pending and threatened litigation and arbitration;
(c) current and potential liabilities;
(d) taxes;
(e) financial statements;
(f) contracts;
(g) employment matters;
(h) environmental matters;
(i) regulatory and permits compliance; and
(j) intellectual property.

Nevertheless, many of these representation and warranties will be specific to the seller's industry.

In many cases, representation and warranties are supported by the issuing of a certificate of good standing (ie financial obligations) or a solvency form from a government office (ie, taxes, payment of pension contributions, etc).

The survival of the representation and warranties will depend on the timeframe specified by the parties in the agreement.

5.2 Conditions of closing of the buyer and seller:

Conditions of closing will vary depending on the industry of the seller and the buyer. Such conditions may involve governmental filings or approvals from the regulators for the transaction, and may include:

(a) environmental permits;
(b) pre-merger authorisation from the antitrust authority; and
(c) approvals from the financial regulator, securities exchange regulator, and so on.

Other conditions may involve corporate approvals or corporate restructurings. Finally, the buyer may also include conditions related to contingencies identified in the due diligence, sought to be fixed by seller before acquiring the company.