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## **Colombia**

### **Negotiated M&A Guide 2022**

Corporate and M&A Law Committee

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## **1. INTRODUCTION**

### **1.1. History and context of M&A in Colombia**

Colombia's economy has grown exponentially during the last few years (with some contraction during 2020 due to Covid-19's effects on private consumption and investment). It is positioned as the fourth largest economy in Latin America and it is expected to continue to grow in the upcoming years. The Organisation for Economic Co-operation and Development (OECD) projects that Colombia's GDP will grow 5.5 per cent in 2022 and 3.1 per cent in 2023.<sup>1</sup>

Economic growth has impacted and activated transactional activity in the country. Colombia's Transactional Track Record's report for 2021 described that M&A activity increased approximately 166 per cent in comparison to 2020 – with a total of 232 deals taking place, reaching US\$13bn in moved capital – which indicates that M&A market is still and has become more dynamic, with cross-border transactions being particularly relevant. Investments resulting from cross-border deals are largely coming from investors in the United States, Spain, and Latin America (eg Brazil, Peru and Mexico).

Traditionally, we have seen dynamic and very active M&A activity in the energy, financial services, health and insurance sectors. In recent years, we have also seen an increase in M&A deals in the infrastructure, fintech, technology and telecommunications sectors. This is associated with the rapid growth in the fintech and technology sectors globally, as well as the country's plan to continue seeking investment and expansion of its toll-road, port and airport infrastructure and the government's interest in promoting the country's 'orange economy'.

For example, in 2020, the government announced an ambitious 5G infrastructure programme that includes 12 megaprojects including toll roads, the development and modernisation of several airports, improvement of port access and river navigability, and the development of railway lines,. It is expected that the projects will attract not only the main local players but international investment. Moreover, the development of alternative energy source projects in Colombia continue to grow, attracting foreign developers and investors.

### **1.2. Impacts of Covid-19**

In response to the Covid-19 pandemic, the Government adopted several measures including preventive lockdown, assigning additional resources to the health system, special credit lines for companies in certain sectors and postponement of due dates for tax collection in other sectors during a limited period of time. In addition, to provide relief to businesses on matters such as labour, tax, credit availability, credit profile, corporate issues and leases, the

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<sup>1</sup> Elements that favoured the growth dynamics, which are generated from regulations and policies implemented by the Congress and Government, were:

- a. the admission of Colombia to the OECD;
- b. initiatives of the government such as the Finance Law, which promoted incentives for private investment and thus a boost to the confidence of local and foreign investors;
- c. lower interest rates, which promoted credit growth and demand for credit, specifically credit destined for housing, which increased real estate property demand;
- d. high migration, which raised private consumption levels;
- e. recently enacted cross-border anti-corruption regulation, which has challenged (but increased the attractiveness of) companies to adapt to international anti-corruption standards, even in sectors where the implementation of anti-corruption protocols and controls was uncommon; and
- f. the positive performance of public construction and construction of social interest housing favoured by public policies of the central and local governments.

Government issued a number of regulations and policies that impacted businesses' legal framework.

Despite economic and regulatory relief, and financial institutions' pledges that they would provide refinancing alternatives and facilities to companies affected by the Covid-19 outbreak, it was expected that multiple businesses would have to resort to remedies offered by the law to companies in distress, in insolvency or at risk of falling into it. Consequently, one of the most relevant regulatory changes was to the bankruptcy law in Colombia.

In March 2020, the Colombian government issued Decree 560, whereby special transitional measures were adopted to the bankruptcy regime. The decree aimed to reduce the duration of the reorganisation process through the implementation of extrajudicial processes with fewer stages and judicial intervention, in which the debtor, within a period of three months, determines with its creditors the mechanisms to resolve the situation of insolvency.

The regulation provided in Decree 560 applies to companies whose businesses have been affected as a result of the Covid-19 emergency. Through this Decree, more expeditious and efficient processes were implemented. Additionally, and particularly interestingly for M&A activity, the Decree provides that if a creditor is in the capacity of preventing liquidation of a debtor, it can make capital contributions to such debtor.

### **1.3. Summary of legal landscape**

#### **1.3.1. Commercial legal framework**

Colombia's legal system is essentially codified. Case law, in principle, constitutes secondary criteria for the judges who, pursuant to the Colombian Constitution, are only bound by the rule of law when issuing their decisions.

Colombian private commercial and corporate law maintains a dichotomy of codes that coexist in parallel as two major regimes: (1) the civil, ruled by the Civil Code issued in 1873 (Civil Code) and (2) the commercial, ruled by the Commerce Code issued in 1971 (Commerce Code). In principle, all mercantile matters are ruled by the Commerce Code, which in any case includes a direct reference to the provisions of the Civil Code. The following key legal principles of Colombian contract law are relevant to M&A deals:

##### *Private autonomy*

This principle provides that parties to a contract have private autonomy in the drafting and execution of commercial contracts and that, unless conditions therein are contrary to the mandatory legal rules, public order and good customs, the rule of contract will prevail. Under this principle, individuals are allowed to regulate their relationships freely.

In consequence, the extent of the flexibility of the terms and conditions that can be agreed by the parties of an M&A deal will largely depend on the structure and type of contract that will be negotiated. For instance, while merger procedures are regulated extensively by the Commerce Code, leaving little space to the parties to dictate the process and its consequences, the economic terms and conditions may be freely agreed upon by the merging parties or their stakeholders. On the other hand, there is much more flexibility on the terms and conditions of share and assets purchase agreements.

### *Good faith*

Good faith corresponds to the standard that the parties must maintain during the execution and performance of the contractual relationship, which implies that the contracting parties must act in a correct, honest, loyal, transparent and diligent manner. From the subjective point of view, good faith is composed of the belief and conviction that a person has towards the business.

The Commerce Code states that good faith not only affects the content of the contracts but its performance, binding the parties not only to what is expressly agreed, but to what is essentially and naturally required from them according to the law, custom and equity. In other words, obligations that bind the contracting parties include all such actions/inactions that are necessary to fulfil the purpose of the business regulated in the respective contract. This, as further explained below, is particularly relevant to pre-agreements.

#### **1.3.2. Foreign investment**

The cornerstone of foreign investment regulation in Colombia is the principle that foreign investors will receive the same treatment as local investors (and vice versa). Foreign investment is generally permitted in all economic sectors except for (1) national defence and (2) the processing or disposal of hazardous waste not produced in Colombia. There are also restrictions applicable to the financial, public television, private security and surveillance sectors. Foreign investment in Colombia is subject to registration with the Colombian Central Bank (Banco de la República). Accordingly, all foreign investments made in Colombia by a non-Colombian resident must be registered with the Central Bank.

#### **1.3.3. Merger control regulation**

Under applicable anti-trust regulations, namely Law 1340 of 2009, any integration operation affecting the Colombian market, even if carried out offshore, may require prior clearance from the Colombian antitrust authority, the Superintendence of Industry and Commerce (SIC). Clearance can take place through notification of the transaction to SIC or obtaining prior authorization. The determination of whether authorisation is needed or notification is sufficient, will depend on the relevant market share. Clearance (notification or authorisation) is required when the following conditions are met:

- (a) *Acquisition of competitive control*: One of the parties to the transaction acquires ‘control’ over the business of the other party. For antitrust purposes, ‘control’ is understood as the mere de facto possibility of influencing strategic decisions.
- (b) *Market overlaps*: The parties are engaged in the same business (horizontal overlap) or carry out activities within the same value chain (vertical overlap), directly or indirectly, through other controlled corporate vehicles.
- (c) *Economic threshold*: During the fiscal year preceding the transaction, the parties (including all the companies that are controlled or have control over the parties) had, individually or in the aggregate, operating incomes or total assets amounting to an equivalent of 60,000 Colombian minimum legal wages (approximately US\$15m in 2022).

#### **1.3.4. Relevant regulators**

In addition to antitrust clearance, M&A deals may require authorisation from other regulators.

This will largely depend on the market in which the parties operate and whether M&A transactions are observed and regulated for that specific market. In our experience, M&A deals related to certain health activities (ie health promotion entities or *EPS* in Spanish) will require authorisation from the corresponding regulator (the Superintendencia Nacional de Salud); similarly, Superintendencia Financiera de Colombia approval is required for IPOs of companies in the banking and insurance sectors.

## **2. TRANSACTION STRUCTURES**

The Commerce and Civil Codes include provisions that establish a general legal framework for the transfer of shares and assets. Among the most relevant are the sale and purchase of shares, the sale and purchase of assets, and mergers and spin-offs. Other structures like joint ventures are considered atypical contracts constructed as per general contract law principles and interpretation of laws applicable to private commercial law.

### **2.1. Sale and purchase of shares:**

Shares of corporations (*sociedades anónimas* and *sociedades por acciones simplificadas*) are negotiable without restriction, except when (1) restrictions to transfer of shares are included in the company's bylaws or shareholders agreements – eg, right of first offer (ROFO) or right of first refusal (ROFR) clauses – or (2) transfer of shares requires authorisation by a regulator. The transfer of shares of corporations is completed with the registration of such transfer in the shareholders registry ledger and delivery of the respective share certificates.

Transfer of quotas of limited liability companies (*sociedades de responsabilidad limitada*) are subject to pre-emptive procedures (regulated by law) and require registration before the Chamber of Commerce. The transfer of quotas of limited liability companies is completed with the registration of the transfer with the Chamber of Commerce. Disclosure of names of new shareholders is required.

#### **2.1.1. Main advantages**

Transfer of shares of Colombian corporations is generally simple and expeditious: it does not require registration before Chamber of Commerce, third-party authorisations to close the transaction are (usually) limited and parties have a good measure of flexibility to agree the terms and conditions of the sale and purchase of the shares.

#### **2.1.2. Main disadvantages**

The target company continues to carry liabilities; consequently, the buyer will become indirectly liable for the company's losses in proportion to its participation in the target company. The buyer's liability can be limited with indemnity obligations set forth in the respective share purchase agreement or by including carve-out obligations as conditions precedent. As a result, extensive due diligence usually takes place to identify material red flags that can affect the transaction or the buyer's interest in the target company; thus, the due diligence report is a key document for negotiation of the transaction documents.

Since the target company is not a party to the agreement, non-selling shareholders of the target company or the target company itself can refuse to deliver privileged information for completion of the due diligence. Similarly, there is difficulty in performing due diligence over listed companies since the information made available to potential investors and their advisers is generally limited to the information that the public can access.

### 2.1.3. Transaction documents

Shares sale and purchases can be formalised with a simplified share transfer instrument (including minimal instructions of seller to the target company requiring registration of the share transfer) or a share purchase agreement including detailed terms and conditions. If the former is used, the legal provisions of the Commerce Code will apply, whereby the seller will be liable for losses suffered by the buyer resulting from facts, circumstances or omissions relating to the target company that took place prior to closing, if these were not disclosed to buyer. Ancillary documents such as shareholders' agreements, disclosure letters and escrow agreements are often used in deals relating to Colombian targets/parties. Please see a brief description of important considerations relating to escrow agreements and shareholders agreements in Section 3.3 below.

### 2.1.4. Tax considerations

Sale of shares is subject to an income tax that will depend on the number of years that the seller held the shares before their sale. The income tax rate is 10 per cent if shares have been held for more than two years (occasional gain) or 35 per cent (for 2021) if shares have been held for less than two years (ordinary rent).

The purchase price will be subject to withholding tax when the buyer is a local entity and the seller is a foreign entity. As a general rule, this withholding is of 2.5 per cent. Withholding tax does not apply for the sale and purchase of shares when the buyer and seller are local entities.

In any case, for tax purposes, the purchase price of shares of a Colombian company must be at least 130 per cent their intrinsic value.

### 2.1.5. Typical conditions for closing

We have identified four key conditions to closing that we often see in share sale and purchases in Colombia, other than market-standard closing conditions such as absence of material adverse effect, no injunction, compliance of representations and warranties, etc.

- (a) *Authorisation from third parties if there are change of control provisions in contracts:* Change of control provisions in contracts under Colombian law are not legally required provisions. Thus, change of control is generally permitted and does not require authorisation from parties to the respective contracts unless agreed in the respective contract. Please note that the same applies generally for licences and permits.
- (b) *Obtaining waiver of ROFO or ROFR:* ROFO and ROFR are provisions that are commonly found in Colombian companies' bylaws. A waiver of these rights must be obtained from the company and each of the shareholders that are not selling their shares. Please note that if shareholders of the target company have entered into a shareholders' agreement, additional transfer restrictions/conditions may apply (eg, tag-along, drag-along, etc).
- (c) *Obtaining regulator authorisation:* it can be necessary to obtain authorisation from a specific regulator, depending on the market in which the target company or seller operates.
- (d) *Obtaining anti-trust clearance:* see Section 1.3.3.

## **2.2. Share subscription**

Corporations (*sociedades anónimas* and *sociedades por acciones simplificadas*) can, if authorised by the shareholders assembly and in the terms and conditions approved by the board of directors, issue shares to a third party in exchange for cash or in-kind contributions or through the capitalisation of an account payable. ROFR provisions can be included in the company's bylaws with respect to shares issuance, whereby shareholders have the right to refuse the share subscription offer before such shares are offered to a third party. The subscription of shares of corporations is legally completed with the registration in the shareholders registry ledger and delivery of the respective shares' certificates. In addition, all share subscriptions must be registered with the Chamber of Commerce – disclosure of names of new shareholders is not required.

Subscription of quotas of limited liability companies (*sociedades de responsabilidad limitada*) are subject to pre-emptive procedures (regulated by law) and require registration before the Chamber of Commerce. The subscription of quotas of limited liability companies is completed with the registration of the quota subscription with the Chamber of Commerce. Disclosure of names of new shareholders is mandatory.

### **2.2.1. Advantages**

Subscriptions of shares of Colombian corporations is generally simple and expeditious, third-party authorisations to close the transaction are (usually) limited and parties have a good measure of flexibility to agree the terms and conditions of the subscription of shares. For instance, payment of subscribed shares in simplified stock corporations can be made within two years following the share issuance. Payment of subscribed shares or quotas can be made with contributions of cash, in kind or with the capitalisation of an account payable. Corporations and simplified stock corporations can issue different types of shares.

### **2.2.2. Disadvantages**

The target company continues to carry liabilities and, in consequence, the buyer will become indirectly liable for the company's losses in proportion to its participation in the target company. The buyer's liability can be limited with indemnity obligations set forth in the respective share subscription agreement or by including carve-out obligations as conditions precedent. As a result, extensive due diligence usually takes place to identify material red flags that can affect the transaction or buyer's interest in the target company; thus, the due diligence report is a key document for negotiation of the transaction documents. As with share purchase arrangements, it is difficult to carry out due diligence over listed companies since the information made available to potential investors and their adviser is generally limited to the information that the public can access.

### **2.2.3. Transaction documents**

Share subscriptions can be formalised with the general shareholders assembly's minutes and the board of directors' minutes, or with a subscription agreement including detailed terms and conditions. If the former is used, legal provisions of the Commerce Code will apply, whereby the company will not be liable for losses suffered by buyer on investment. Ancillary documents such as shareholders' agreements, disclosure letters and escrow agreements are often used in deals relating to Colombian targets/parties. Please see a brief description of important considerations relating to escrow agreements and shareholders agreements in Section 3.3.

#### **2.2.4. Tax considerations**

Contributions of cash or assets to Colombian companies are generally tax-neutral (provided that certain conditions are met). The transaction will require registration of the capitalisation of the company before the Chamber of Commerce, which includes payment of a registration tax of 0.7 per cent of the amount contributed to the company as capital and 0.3 per cent of the amount contributed to the company as premium value.

#### **2.2.5. Typical conditions for closing**

Closing conditions applicable to shares sale and purchase transactions apply *mutatis mutandis* to share subscription transactions. Please see Section 2.1.7.

### **2.3. Sale and purchase of assets, including acquisition of ongoing business establishment**

The sale and purchase of assets is generally governed by the Commerce and Civil Code.

Please note that the sale and purchase of assets and liabilities of an ongoing business can be construed as the sale and purchase of a commercial establishment,<sup>2</sup> which requires additional formalities and, pursuant to applicable law, the buyer and seller will be jointly and severally liable for obligations of the respective commercial establishment for a period of two months after closing. Sale and purchase contracts can include special provisions with the purpose of differentiating the sale and purchase of assets and liabilities from a commercial establishment.

#### **2.3.1. Main advantages**

The sale and purchase of assets allows the buyer to choose assets and liabilities that it will acquire, and parties have a good measure of flexibility to agree on terms and conditions of the sale and purchase. In addition, liability transferred to the buyer is limited and, unless the target is part of a regulated market (eg financial, insurance, health or security) or antitrust clearance is needed, no regulator authorisation is required.

#### **2.3.2. Main disadvantages**

The process to transfer assets and liabilities can be complex and time consuming and will likely require third-party authorisation (creditors or debtors). In addition, if real estate property or intellectual property is among the assets that are being sold, such transfer will require registration and, with respect to transfer of real estate property, payment of registration tax. In addition, registration of the purchase and sale of the commercial establishment with the Chamber of Commerce requires payment of a registration fee equivalent to 0.7 per cent of the purchase price.

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<sup>2</sup> The Commerce Code sets forth a non-exhaustive list of the elements that are part of the commercial establishment, including, but not limited to: (1) industrial and intellectual property; (2) inventories of raw materials and finished products; (3) accounts receivable; (4) furniture and facilities; (5) lease agreements; (6) the right to prevent the 'deviation of clients and to the protection of goodwill'; and (7) the rights and obligations arising from the activities in which the commercial establishment is engaged, except for those arising from intuit personae contracts (entered into based on personal and individual qualities of the owner of the commercial establishment).



### 2.3.3. Transaction documents

Assets sale and purchases can be formalised with an assets purchase agreement. Other than specific identification of the assets and liabilities that will be transferred (which is not necessary when transfer is in the form of a commercial establishment sale and purchase), there are no legal requirements for this contract. If a simplified form is used, legal provisions of the Civil and Commerce Code will apply whereby the seller will be liable for losses suffered by the buyer resulting from facts, circumstances or omissions relating to the target company that took place prior to closing, if these were not disclosed to buyer. Ancillary documents such as disclosure letters and escrow agreements are often used in deals relating to Colombian targets/parties. Please see a brief description of important considerations relating to escrow agreements and shareholders agreements in Section 3.3.

### 2.3.4. Tax considerations

Sale of assets is subject to an income tax. The rate applicable to gross income will correspond to:

- (a) the classification of the asset as fixed for tax purposes;
- (b) that said fixed asset has been owned for less or more than two years; and
- (c) that the profit has been allocated first to the net income for recovery of depreciation and amortisation.

The rate can be 10 per cent or 35 per cent (for 2022). Please note that the tax cost of internally formed intangible assets is zero.

The purchase price will be subject to withholding when (1) the buyer and seller are local entities and the assets held in Colombia and (2) when the buyer is a local entity, the seller is a foreign entity and the assets are held in Colombia. In the first case, as a general rule, the withholding rate is 2.5 per cent (for 2022). In the second case, the withholding rate will be 10 per cent or 15 per cent (for 2022) depending on the time during which assets were held by buyer. Withholding tax will not apply for the sale and purchase of assets where the buyer is a foreign entity and the seller is local.

In addition, the seller must invoice VAT (19 per cent for 2022) for the portion of the purchase price allocated to inventory and current assets that are being transferred.

The valuation of the commercial establishment should be carried out considering the commercial value of each of the assets that make up said commercial establishment. In any case, the commercial value assigned to each asset cannot deviate by 15 per cent from the average commercial value of similar assets. Moreover, in the acquisition of commercial establishments, the acquirer must register a capital gain equivalent to the difference between the sale value and the net equity value of the assets that are being sold.

### 2.3.5. Typical conditions for closing

We have identified five key conditions to closing that we often see in assets sale and purchases in Colombia, other than market-standard closing conditions such as absence of material adverse effect, no injunction, compliance of representations and warranties, and so on.

- (a) *Authorisation from third parties for the assignment of contracts:* assignment of contracts is permitted by law, unless (1) contracts were entered on an *intuit personae*

- (contracts specific to a certain person only) basis or (2) the contract includes assignment restrictions explicitly.
- (b) *Authorisation from shareholders*: restrictions to dispose assets and liabilities can be found in Colombian companies' bylaws. As a rule, unless agreed differently in its bylaws, the disposal of more than 50 per cent of assets and liabilities of a simplified stock corporation will require authorisation of the general shareholders' assembly.
  - (c) *Labour matters*: if the respective assets sale and purchase include the transfer of some or all employees to the buyer, there are three ways in which employees in Colombia may be transferred among companies: (1) the termination of the existing employment agreements followed by the entering into new employment agreements; (2) employer substitution; and (3) the assignment of the employment agreements. The most expeditious manner is through an employer substitution – it does not require intervention of the employees, but it transfers labour liabilities to buyer.
  - (d) *Obtaining regulator authorisation*: it may be necessary to obtain authorization from a specific regulator, depending on the market in which the target company, buyer or seller operates
  - (e) *Obtaining anti-trust clearance*: see Section 1.3.3.

#### **2.3.6. Specific considerations**

Under Colombian law, absent or dissenting shareholders have the right to withdraw from the company in the event of a sale of more than 50 per cent of assets and liabilities of a simplified stock corporation that results in an impairment of equity. The value by which the shares of the absentees or dissidents must be acquired is determined by mutual agreement between the retiring shareholder and the other shareholders or, failing that, with the company. If there is no agreement, the price for the reimbursement will be determined by experts.

### **2.4. Mergers and spin-offs**

Mergers and spin-offs are corporate reorganisation structures regulated by the Commerce Code and related legislation. The contents of the merger and spin-off agreement/projects and formalities to implement them are regulated extensively and in detail.

#### **2.4.1. Advantages**

Mergers and spin-offs are usually attractive alternatives for the reorganisation of company groups. Unless the target is part of a regulated market (eg, financial, insurance, health or security) or antitrust clearance is needed, no authorisation of regulators is required. Mergers and spin-offs are generally tax neutral (provided that certain conditions are met).

#### **2.4.2. Disadvantages**

Mergers and spin-offs are subject to specific regulation, parties have less flexibility to agree on terms and conditions, and they will require approval by the shareholders' general assembly. In addition, extensive formalities must be observed, including registration in public deed and before the Chamber of Commerce.

#### **2.4.3. Transaction documents**

A merger is formalised with a merger agreement and a spin-off is formalised with a spin-off project. Due to extensive regulation on these structures, the contents and terms of each of these documents are dictated by what is required in applicable law and regulation. Negotiation is usually around valuation and, in connection with mergers, the applicable exchange ratio, representations, warranties and indemnities.

#### **2.4.4. Tax considerations**

Mergers and spin-offs are generally tax neutral (provided that certain conditions are met). If real estate is being transferred as part of the merger or spin-off, this shall also be transferred before the real estate registration office and a registration tax must be paid on the transfer.

#### **2.4.5. Specific considerations**

Under Colombian law, absent or dissenting shareholders have the right to withdraw from the company in the event of a reorganisation, merger or spin-off of a corporation that results in greater responsibility allocated on the shareholders or implies a deterioration of their economic rights. The value by which the shares of the absentees or dissidents must be acquired is determined by mutual agreement between the retiring shareholder and the other shareholders or, failing that, with the company. If there is no agreement, the price for the reimbursement will be determined by experts.

#### **2.5. ‘Mix and match’**

In our experience, we have seen transactions taking place through a variety of the transaction structures described above (eg, spin-off and shares sale and purchase, share contribution and share sale and purchase, etc).

In addition, based on the contract private autonomy principle, we have seen deals structured as master investment agreements, joint-venture agreements and others that collect elements of the share purchase, share subscription and asset purchase agreements to transfer assets and securities among various parties.

### **3. MAIN TRANSACTION AGREEMENTS**

Acquisition contracts, regardless of the transaction structure, must be written. They can be drafted in English or Spanish. Spanish will prevail in a court of law or with governmental authorities. Pursuant to applicable law, contracts can be signed electronically, digitally or in writing. Please note that various acquisition contracts (SPAs, APAs, IMAs) relating to Colombian target companies can be executed under governing laws different to Colombian law.

#### **3.1. Key clauses in sale and purchase agreements**

In practice, M&A agreements in Colombia are structured and drafted similarly to M&A agreements in common law practice, whereby clauses such as price, price adjustment, representations and warranties, pre-closing and post-closing covenants, closing conditions and indemnities are included. Note also that courts in Colombia have accepted and enforced these types of contracts.

The following are clauses that have special key considerations under Colombian law.

##### **3.1.1. Business covenants**

Interim covenants must be drafted and negotiated carefully. If too extensive, it could be considered that buyer has acquired control of the target company before obtaining antitrust clearance. As a result, the Superintendence of Industry and Commerce could investigate and fine the parties.

### 3.1.2. Contract exits

Since regulators have the capacity to condition their authorisation, we always recommend including the possibility to terminate the contract when burdensome conditions – like disposing of assets or divestitures – are imposed. Also, due to the pandemic and political context, the negotiation of the definition of ‘material adverse effect’ in the contract and exclusions has become key in the negotiation of purchase agreements.

### 3.1.3. Sandbagging/anti-sandbagging

The legal default rule provided in the Commerce Code is mainly that the seller will be liable for losses suffered by the buyer resulting from facts, circumstances or omissions relating to the target company occurring prior to closing, provided that these were not disclosed to the buyer and the buyer, in turn, is responsible for performing professional due diligence. However, per the private autonomy principle, parties can negotiate and assign liabilities among themselves in the respective contract, including, for example, a sand-bagging clause.

### 3.1.4. Indemnities and damages

In Colombia, civil liability may originate in contracts or torts. Generally, and according to Colombian case law and jurisprudence, indemnifiable damages derived from contracts and torts must be: (1) real, (2) certain, (3) personal and (4) direct. They may be patrimonial or non-patrimonial (explained below) and must be proven. Consequential damages, indirect damages or punitive damages are not recognized under Colombian law.

Relevant to M&A agreements, indemnity limitations and types of damages that can be claimed in the context of such agreements can be agreed among the parties (within the framework of applicable law). Types of damages in Colombia can be described as follows:

- (a) Direct patrimonial damages comprise actual damages (*daño emergente*), which is the financial loss that the victim’s equity has borne or will bear, and loss of profits (*lucro cesante*) that consists in not receiving an asset that should have formed part of the victim’s equity and which in Colombia is considered as a direct damage.
- (b) Non-patrimonial damages include: (1) damages for pain and suffering (*daño moral*); (2) damages inflicted to physical or psychological health (*daño fisiológico*); and (3) other damages related to fundamental rights such as those which harm reputation, image, honour, etc. Although they are usually derived from tortious liability, it may also be possible to claim them based on contractual liability.

### 3.1.5. Dispute resolution:

Colombian law provides that contracts performed within Colombian territory are subject to Colombian law. If parties decide that dispute resolution will take place through arbitration (local or international), there must be an agreement among the parties stating this explicitly. Parties can agree to international arbitration when certain requirements are met:

- (a) the parties to the agreement are domiciled in different countries at the time of the execution of that agreement;
- (b) the place where a substantial part of the obligations of the commercial relationship will be performed, or the place with which the subject matter of the dispute is most closely connected, is different from the parties’ domicile; or
- (c) the dispute submitted to arbitration affects the interests of international trade.

### **3.2. Escrow agreements in Colombia**

Escrow or purchase holdback agreements are common in the context of M&A negotiations in Colombia. Escrow agreements must be structured by means of a trust agreement – *contrato de fiducia mercantil en garantía* – whereby a trustee will receive and keep a certain amount to be disbursed to buyer or seller (who will act as trustors and beneficiaries in the contract) after a period of time, as instructed in the trust agreement. Since trustees are regulated entities in Colombia (*entidades fiduciarias*), overseen by the Superintendence of Finance, they will usually provide a first draft of the agreement to the parties.

Although there is flexibility to negotiate some terms and conditions of these agreements (ie, time during which amounts/assets will be held, conditions for disbursement, etc), negotiation with trustees can be difficult due to the extensive regulations that they are subject to.

### **3.3. Shareholders' agreements in Colombia**

Depending on the target company type, shareholders' agreements can be structured by means of a voting agreement or a general shareholders' agreement. It usually contains general governance provisions and does not require that the target company become a party to it. When a shareholders' agreement is executed, it must be submitted to the company for keeping in its records.

## **4. PRE-AGREEMENT DOCUMENTATION**

Pre-agreements follow the same principles as agreements under Colombian private law. Parties have private autonomy to agree their terms and conditions as they deem appropriate (limited, of course, to mandatory legal rules, public order and good customs) and must exercise good faith in their negotiations and agreements. For instance, the Commerce Code states that if a party to a pre-agreement acts in absence of good faith, they can be held liable for damages suffered by the other party. Accordingly, unless it is explicitly stated that a pre-agreement is executed or delivered on a non-binding understanding, parties will be bound to the content set forth therein.

Pre-agreements can be written in the form of term sheets, letters of intent, memorandums of understanding, offers (binding and non-binding) and so on. Pre-agreements are valid as long as they contain key elements of the business, such as identification of the asset that will be transferred and preliminary indication of the purchase price (which can be subject to further adjustments/re-negotiation).

Depending on the depth of preliminary negotiations, these would include certain levels of detail. Commonly pre-agreement documents would include high level description of clauses addressing:

- (a) transaction structure;
- (b) conditions to enter into final documentation (eg due diligence);
- (c) general governance terms (if share purchase is partial);
- (d) indemnity scheme;
- (e) key conditions precedent;
- (f) exclusivity;
- (g) confidentiality;
- (h) binding or non-binding nature of the pre-agreement.

## **5. DUE DILIGENCE STAGE**

Due diligence is carried out on traditional key aspects such as corporate, contracts, tax, financial, and intellectual property. In addition to these, we believe it is important to be cognisant of the following matters.

### **5.1. Anti-money laundering**

Legislation and regulatory entities have adopted regulation and imposed specific requirements for companies that meet certain conditions or undertake certain activities to: (1) adopt manuals and appoint compliance officers to address anti-money laundering and counter-terrorism; and/or (2) make reports to surveillance entities regarding suspicious activities identified in the day-to-day operation of the respective company.

### **5.2. Data protection**

Privacy laws in Colombia provide that an individual's and/or a family's privacy and good name are subject of special protection. Any operation involving the collection, storage, use, circulation and suppression of private data must meet all legal requirements and conditions. Investigations and sanctions to a company that fails to apply these requirements can be material.

### **5.3. Foreign investment**

In the context of a share purchase deal where seller is foreign, we always recommend confirming that seller has registered its investment in the target company before the Central Bank. This is relevant because the buyer must inform the Central Bank that it has substituted the seller as shareholder in the respective target company at closing. To complete registration, seller must have completed its own foreign investment registration. The registration of the foreign investment grants the following exchange rights to the foreign investor:

- (a) the right to reinvest profits or hold retained profits in the surplus;
- (b) to capitalise all invested sums;
- (c) to wire net profits to accounts abroad; and
- (d) wire all amounts received from the sale of its investment in Colombia or derived from the liquidation of the company or from the reduction of its capital to accounts abroad.

### **5.4. Labour**

The Colombian labour regime is considerably protective of employees. Employers have extensive obligations with respect to payment of salaries, benefits, social security contributions, adoption of manuals and appointment of committees. A detailed labour due diligence is always recommended, especially in the context of transactions structured as share purchases or share subscriptions.

### **5.5. Common issues**

Issues that are commonly found and raised in our due diligence processes as red flags largely depend on the industry of the target company that is being reviewed. Nonetheless, we see that labour, data privacy and foreign investment matters are common across all sectors. All findings should be addressed in the sale and purchase contracts through all possible and standard market protections: conditions precedent, representations and warranties, specific indemnities or purchase price adjustments.

## **6. POST-CLOSING**

### **6.1. Foreign investment registration**

Foreign direct investments made by a buyer through purchase of share or assets are considered exchange operations that have to be registered with the Central Bank. To do so,

such operations must necessarily be transferred or negotiated through an authorised intermediary of the exchange market (IMC) or through a compensation account.

Absence of registration of foreign investment after closing of a transaction would limit the buyer's rights, as described in Section 5.3, and likely result in penalties associated to the failure to comply with the exchange regime.

## **6.2. Control registration**

Colombian law provides that a company is subordinated or controlled whenever its decision-making power is subject to the will of other or others, whether by virtue of a share majority, contractual terms, or otherwise. The existence of a control situation must be disclosed and registered before the Chamber of Commerce of the domicile of the company within 30 working days following the date on which the control situation was constituted.

The registration of a control situation under Colombian law triggers, among other obligations, the obligation of the registered parent company to prepare and release consolidated general purpose financial statements for all registered controlled entities for each fiscal year. If the registered controlling entity is a foreign entity, the obligation to consolidate financial statements is only directed at Colombian subsidiaries. Therefore, the Colombian subsidiary with the highest equity shall oversee the preparation and release of consolidated general purpose financial statements.

Even though Colombian law should not be applicable to controlling entities abroad, regulation on control is applicable without distinction as to the place of incorporation of the controlling entities. Therefore, the foreign controlling entity would have to comply with the International Financial Reporting Standards (IFRS) regulation applicable to their jurisdiction.