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## **Colombia**

### Negotiated M&A Guide

Corporate and M&A Law Committee

#### **Contact**

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## **1. Legal Framework**

- 1.1 For corporate and commercial matters, the general legal framework is the Colombian Commercial Code (Decree 410/1971, as amended). Aspects that are not expressly regulated therein shall be decided using analogy to other applicable laws or in the event that analogy is not applicable, the Colombian Civil Code shall apply.
- 1.2 The Colombian Commercial Code has been modified several times, relevant to M&A deals or corporate aspects, the Code was modified and complemented by Law 222/1995 governing basic corporate aspects. Following, Law 1258/2008 introduced new reforms including the creation of a new simplified stock corporation. Law 550 of 1999 was the governing regimen regarding bankruptcy and reorganizations procedures, it was later amended by Law 1116/2006, which implemented a new bankruptcy and reorganization regimen for insolvent companies in Colombia.
- 1.3 Law 1340/2009, complemented by decrees, circulars and opinions, enacted from time to time, by the Superintendency of Corporations or the Congress governs matters related to competition and antitrust procedures. As a general rule, any corporate combination, regardless the transition structure amongst competitors or parties in the same market or distribution channel, including horizontal or vertical integration that meets certain economic and market share thresholds shall require prior filing and antitrust approval. Approvals may take up to 3-6 months. Transactions that meet other smaller thresholds may be subject to notification and not approval. Main governmental entities include: Superintendency of Corporations in charge of general surveillance of corporate entities in Colombia and other corporate aspects; Superintendence of Industry and Commerce is the entity in charge of reviewing the antitrust authorizations concerning M&A transactions; Superintendency of Finance, surveys financial institutions including antitrust approval or bankruptcy (take over) procedures for those entities. Local Chambers of Commerce in each city are the entities in charge of incorporation of corporate entities and registration for many corporate matters amongst others.
- 1.4 Antitrust regulations shall be observed. Currently the parties that participate in the M&A shall either (i) deliver notice to the Colombian antitrust authority (*Superintendencia de Industria y Comercio*) or (ii) obtain, from the same authority, and authorisation to enter into the integration agreement if and when certain thresholds that refer to total assets and total gross sales plus a 20% market share are present.

## **2. Transaction Structures**

M&A transactions can vary in form and structure. Main corporate transactions to undertake an M&A deal include amongst others: sale of assets, sale of shares, merger or combination, joint ventures agreements, acquisition of on-going business establishment or spin-offs or divestures.

### **2.1 Purchase of Assets**

- 2.1.1 Sale of assets would be governed by general provisions included in the Code of Commerce and Civil Code, and seller will be liable (according to law) and in addition to any liability agreed amongst the parties in the APA or transfer document, for hidden or unrevealed defects of the goods being sold.
- 2.1.2 An asset purchase is usually instrumented by means of an Asset Purchase Agreement (APA) that allows the Buyer to acquire specific, individualised assets, and not the whole company.

2.1.3 Main advantages of a purchase of assets structure from a legal perspective include:

- (a) Buyer is not responsible for seller's liabilities (others than those expressly assumed or related specifically to the assets being acquired) including environmental, labor or tax matters at the seller's company level;
- (b) Buyer can "*cherry pick*" assets it requires and leave behind other non-desired assets, elements or situations at the selling company level.

2.1.4 Main disadvantages of a purchase of Assets from a legal perspective include:

- (a) Transfer process of individual assets may be more complex, time consuming and costly than transfer shares;
- (b) Assignment of contracts, licenses, permits, authorizations etc., (if applicable) may require longer times and further procedures, in particular if filings, notifications or third party consents are required;
- (c) Transfer tax and Value Added Tax may be applicable depending on the assets being sold. There may be less flexibility to implement a tax planning structure. Buyer acquires cost of goods sold from Purchaser and consequently potential capital gain in the future if any.

2.1.5 An alternative structure to mitigate some of the downfalls of an acquisition of assets, may be to implement the transaction by means of an acquisition of an on-going commercial establishment as explained in section 2.4 below.

## **2.2 Purchase of Shares**

2.2.1 Colombian law does not regulate share purchase transactions specifically from a commercial standpoint. Most terms and conditions can be freely agreed among the parties. Most purchases of shares are implemented through a share purchase agreement (SPA), or Subscription Agreement (SA) or Master Investment Agreement (AMI for its letterheads in Spanish) if the purchaser is acquiring newly issued shares from the company.

2.2.2 The validity of a share purchase is subject to recording of the transfer with the issuing company in the Shareholders Registry Book. Nevertheless the company's bylaws should be reviewed for pre-emptive rights or rights of first refusal granted to either or both the company and/or the remaining shareholders. For the transfer of participations in limited liability companies (LLC's), the transfer needs to be subject to pre-emptive rights and must be executed through a public deed before a public notary. Public deed of transfer for LLC's shall also be recorded before the Chamber of Commerce.

2.2.3 The securities market regulation has special provisions for listed companies when a purchase of shares occurs. If the price of the business purchased is greater than 66.000 units of real value (UVR), it must necessarily be conducted through the Colombian Stock Exchange Market.

2.2.4 From a tax perspective, seller incurs in capital gains tax at the applicable rate on the sale of shares, unless it is a publicly traded company in which case such tax will apply only to those shareholders selling more than 10% of the outstanding shares of the company.

2.2.5 Ancillary transaction documents such as earn-outs, escrow (or other applicable guarantee agreements such as a pledge), labor agreements with key employees and/or shareholders agreements if acquisition is not for 100% for the company's equity are common.

2.2.6 Main advantages of a purchase of shares from a legal perspective in comparison to a sale of assets include:

- (a) A share purchase is usually faster and easier to effect than an asset purchase;
- (b) Fewer authorizations may be required as individual assignment of contracts, licences, permits or other documents may not be required. However change of control provisions may be applicable and must be attended;

2.2.7 Main disadvantages of a purchase of shares from a legal perspective in comparison to a sale of assets include:

- (a) The Company (thus indirectly through its participation in the company the buyer) will continue being liable before third parties and governmental entities for all liabilities of the company being acquired (regardless of agreements between the parties with respect to Seller's liability);
- (b) Extensive due diligence and indemnifications negotiations are required.

## **2.3 Mergers**

2.3.1 Mergers are usually implemented by means of a merger agreement.

2.3.2 Mergers in Colombia are subject to specific legal formalities set forth in the Colombian Commercial Code including the approval of the transaction at the shareholders assembly and compliance with applicable minority rights .

2.3.3 Types of mergers:

- (a) By Incorporation: existing companies cease to exist and a new company is formed. The shareholdings in the new company will have an equity participation equivalent to the value of the assets and liabilities contributed by the companies that ceased to exist as agreed in the merger exchange ratio.
- (b) By Absorption: an existing company ceases to exist as it is absorbed by a surviving entity. All assets and liabilities are by mandate of the law transferred to the surviving entity.

2.3.4 Main considerations of a merger transaction include the following:

- (a) There is no buyer or seller, therefore the culture and spirit of negotiations are slightly different. There is a huge emphasis on valuation and merger exchange rate, but there is no party walking away from the business as seller;
- (b) Does not require a cash payment or disbursement (in principle);
- (c) Universal transfer of assets and liabilities.
- (d) Creditors rights and publications must be observed;
- (e) Absent or dissident shareholders at the shareholders meeting where the merger is approved have minority rights, including a put option of its shares.

## **2.4 Purchase of on-going Business Establishment**

- 2.4.1 According to the Colombian Commercial Code, the sale/purchase of an *establecimiento de comercio*, hereinafter referred as a 'on-going business establishment', is presumed to be carried out as a single operation, without need to individually transfer the specific elements that integrate it.
- 2.4.2 Usually the purchase is implemented by means of an Asset Purchase Agreement, the asset being the on-going business establishment. The sale/purchase agreement shall be granted, either by public deed or in private document duly notarized by both parties.
- 2.4.3 In order to acquire an on-going business establishment, said establishment shall be first created within a company; creation only requires preparation of a balance sheet statement (duly certified by a certified public accountant), underlying the assets and liabilities that make up the ongoing business establishment and registration of the establishment before the chamber of commerce.
- 2.4.4 According to Colombian law, the buyer and the seller will be joint and severally liable for all obligations of the ongoing business establishment for a term of two months (after the closing of the transfer), for the following:

- (a) Liabilities of the commercial establishment that occurred prior to the closing date of the acquisition;
- (b) Liabilities of the commercial establishment acquired or engaged in the ordinary course of business of the establishment;
- (c) Any liability duly recorded in the accounting books or balance sheet of the commercial establishment.

Joint and several liability will cease, following two (2) months after the date when the transfer is registered before the Chamber of Commerce, provided that the following requirements have been previously met:

- (a) Written notice must have been delivered to the creditors, informing them about the sale/purchase;
  - (b) A notice has been published in a nationwide newspaper, announcing the sale/purchase with at least [ ] days prior to closing;
  - (c) That in the two (2) month period previously mentioned, the creditors have not rejected the buyer as their new debtor or have requested additional guarantees.
- 2.4.5 Creditors of sellers that object the transfer shall register their opposition against the new debtor before the Chamber of Commerce. Objecting creditors will be entitled to require additional guarantees or security for the payment of their obligations, and if such are not met all pending obligations will be accelerated and shall be complied with.
- 2.4.6 Liabilities that have not been registered in the accounting books will continue to be the responsibility of the seller of the business establishment; however if the buyer did not act in good faith it might be deemed joint and severally liable.

## **3. Preliminary transaction documents**

- 3.1 An M&A transaction may include pre-contractual documentation such as: an info memo, a non-binding letter of intent, a request for proposal (RFP), or an invitation to make an offer or bid.

- 3.2 Once negotiations are initiated it is common to draft documents agreed upon amongst the parties that outline key terms of the proposed transaction. Common documents may be: term sheets, memorandums of understanding (MOU), letters of intent (LOI) accepted by seller. Some provisions of the agreements may be binding (such as good faith, due diligence, term, applicable law and disputes resolution) and other may be non-binding subject to further negotiations, such as price and other economic considerations.
- 3.3 Preliminary transaction documents generally include: (i) transaction structure; (ii) current economic offer subject to adjustments and due diligence finalization; (iii) due diligence governance; (iv) exclusivity; (v) confidentiality; (vi) main terms and conditions of the transactions documents; and (vii) binding or non-binding nature for each specific section. .

## **4. Transaction documents**

### **4.1 Acquisition Documents**

Acquisition documents, regardless of the transaction structure usually include: standard representations and warranties with respect to the seller and the company; indemnification provisions; covenants between signing and closing, closing procedure and deliverables (if applicable); confidentiality, non-compete and non-solicitation provision amongst many others. Buyer usually seeks indemnification from Seller in respect of (i) specific indemnities; (ii) breaches of representations and warranties and (iii) breach of contractual covenants.

#### **4.1.1 Indemnification**

According to Colombian Civil Law, indemnification for damages includes: the actual damage (*daño emergente*) and loss of profits (*lucro cesante*). Both are deemed to be direct damages. indemnifications can arise from the (i) non-fulfillment of an obligation, (ii) imperfect fulfillment of an obligation, or (iii) delay, hold up, or lateness in the fulfillment of an obligation.

If there is no wilful misconduct of the debtor, it shall only be responsible for the damages that were foreseen or those that could be anticipated at the moment the contract was signed.

If there is gross negligence or wilful misconduct, the debtor shall be responsible for all damages that occurred as a direct and immediate consequence of its actions. (i) non-fulfillment of an obligation, (ii) imperfect fulfillment of the obligation, or (iii) delay, hold up, or lateness in the fulfillment of the obligation.

According to the Colombian case law:

*“Damages can be established by law, by a judge or by the parties. The first scenario occurs when the law values the damages, for example in the case of money obligations. The second situation takes place when a judge establishes them because the law didn’t consider anything in that respect or because the parties didn’t establish them. The third and last situation occurs when the parties establish them through a contract.”*

It is also valid under Colombian law to negotiate a different indemnification regime, including for instance mini thresholds, baskets, caps, survival periods and excluding loss of profits if expressly agreed amongst the parties.

#### **4.1.2 Dispute Resolution**

In Colombia, the parties may agree that in the event of a dispute among them, the dispute can be resolved through several non - judicial mechanisms, as compiled in Decree 1818/1998 and law 1563 of 2012:

- (a) Settlement:
- (b) Arbitration:
  - (i) The arbitration can be in law, in equity or technical:
    - (A) In an *Arbitration in Law* the arbitrators make their decision based on current applicable laws. The arbitrators must be titled lawyers and the parties shall also act through their lawyers, except as set forth in the applicable laws.
    - (B) In an *Arbitration in Equity* the arbitrators make their decision based on common sense and equity.
    - (C) In a *Technical Arbitration* the arbitrators issue their judgment based on their specific knowledge of certain science, art or occupation.
  - (ii) The arbitration can be classified as independent, institutional or legal:
    - (A) Independent Arbitration: parties agree to the applicable rules for the solution of their dispute.
    - (B) Institutional Arbitration: parties submit their dispute to the procedure established by an Arbitration Centre.
    - (C) Legal Arbitration: Whenever the Parties do not agree on the applicable procedure, the arbitration will be based on the current legal dispositions.

The parties can agree to arbitrate through a special provision contained in the agreement executed by the parties (Arbitral Clause Provision) or through an independent document where the parties involved in a dispute agree to resolve it through an arbitral court (compromise).

The parties shall jointly determine the number of arbitrators or will delegate this duty to a third party. In any case, the number of arbitrators shall always be odd. If nothing is mentioned in this respect, the number of arbitrators will be three (3), except for those cases where the dispute is for a minimal amount in which case there will be a sole arbitrator.

The arbitrators shall be appointed by the parties who may delegate such appointment to a third party.

International Arbitration in Colombia is ONLY available pursuant to Law 1563 of 2012 when:

- (A) The parties to an Arbitration Agreement (either by an Arbitral Clause Provision or a Compromise), at the moment of the Agreement, are domiciled in different jurisdictions,
- (B) The place of performance of a substantial part of the obligations or to which the purpose of the litigation has a closer relation is located outside Colombia, or
- (C) When the dispute that is subject to Arbitration affects the interests of international commerce.

In case the Parties do not agree to establish any of the abovementioned non judicial mechanisms, then the matter shall be submitted to Colombian judges who will follow all applicable laws established in the Colombian General Procedure Code. Prior to the submission and admittance of the lawsuit a mandatory settlement hearing shall have taken place. The purpose of this pre-trial hearing is to have the parties try to settle their dispute with the aid of a conciliator.

## **4.2 Shareholders Agreement**

- 4.2.1 Shareholders agreement are recognized under Colombian law to establish voting agreements and must be duly registered before the company to make them enforceable against the company and third parties.
- 4.2.2 Shareholders agreements typically deal with matters such as: (i) corporate governance of the company including shareholders assembly and board of directors structure, meetings, procedure, quorum and approval requirements; (ii) restrictions to transfer of shares (including lock-up periods, pre-emptive rights, rights of first refusal, dead lock resolutions, call & put options, drag along, tag along right and exit events; (iii), special approval majorities; (iv) other covenants for the shareholders or the company, such as information rights, non-compete, labor conditions if a shareholder is also employed by the company); and (v) voting agreements with respect to specific matters.

## **4.3 Guarantees – Escrow Agreements**

- 4.3.1 Under Colombian legal practice it is common to negotiate an escrow or purchase price holdback mechanism to secure Seller's liability obligations under the acquisition agreement if such agreement involves some kind of payment in cash. In the event the agreement does not involve some sort of payment in cash such as a merger, it is common to negotiate a share participation adjustment mechanism or pledge over securities of the surviving entity.
- 4.3.2 Most escrow agreements are implemented by means of a "*Fiducia Mercantil en Garantía*" with a trust company in Colombia. Under this mechanism, the debtor (or seller in this case) transfers one or more assets (including cash) to a trust company that manages the transferred assets and will distribute/allocate them pursuant to the terms and conditions of the escrow agreement. According to Colombian Law the Trustee must be incorporated as a *Sociedad Fiduciaria*.
- 4.3.3 There are two types of trusts in Colombia: (a) *Encargo Fiduciario* and (b) *Fiducia Mercantil*. In a *Fiducia Mercantil* there is an actual transfer of property of the assets whereas in the *Encargo Fiduciario* scheme there is no transfer of the property of the assets, only hand over of the assets for management purposes.
- 4.3.4 Assets transferred to a *Fiducia Mercantil* should have a specific purpose to guarantee an obligation, and are insolvency remote with respect to the debtor/seller.
- 4.3.5 The trust agreement shall be recorded by the creditor before the *Registro de Garantías Mobiliarias* upon which all the direct collection rules and regulations will apply.
- 4.3.6 Trust companies in Colombia must follow, among others, the following duties:
  - (a) Carry out with diligence all necessary acts in order to pursue the purpose of the trust;
  - (b) Act as attorney in the defence and protection of the assets of the trust;



- (c) Invest the assets of the trust as indicated in the trust agreement, except if the trustee has been expressly authorized to act in the way that he considers more convenient; and
- (d) Procure the best return of the assets of the trust.

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