
Honduras

Negotiated M&A Guide

Corporate and M&A Law Committee

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INTRODUCTION

The Code of Commerce is the main regulation for Honduran corporate and commercial law. It contains the main principles and regulations regarding commercial contracts and agreements.

Agreements relating to mergers and acquisitions are not expressly regulated by the Code of Commerce; nevertheless they are permitted by law under the legal institution of “atypical agreements”. According to article 715 of the Code of Commerce, all atypical agreements are ruled by the covenants and clauses agreed upon in them. If there is an issue not covered in the atypical agreement, the Code of Commerce provides that the applicable legal disposition will be that contained in the Code of Commerce or the Civil Code which is most analogous.

STRUCTURE OF THE TRANSACTION

In Honduras, transactions for mergers and acquisitions are generally executed through a stock purchase agreement. In these cases, if the buyer is a foreign company, it is very common for a special purpose vehicle (“SPV”) to be incorporated in Honduras for the purpose of executing the transaction. This legal structure is recommended for mergers as it simplifies some of the legal formalities that would otherwise be required.

Other common types of transactions for mergers and acquisitions are: asset and liability acquisitions (asset purchase agreement) and special merger agreements.

PRELIMINARY CONSIDERATIONS

In this section, the following issues regarding mergers and acquisitions in Honduras should be taken into consideration:

- The two broad and most common types of corporate legal organizations are: the Corporation (*Sociedad Anónima* or SA) and the Limited Liability Company (“LLC”, *Sociedad de Responsabilidad Limitada* or S. de R. L.). The capital stock of a Corporation is divided into shares that can be represented by (registered or bearer) certificates. The capital of a Limited Liability Company is divided into social participations that are not securities in character, cannot be represented by certificates or book entries, or called tradeable shares of stock.
- Article 43 and 77 of the Code of Commerce require that transfers of social participations of an LLC be authorized by all of the partners or by the majority of the partners (if agreed in the incorporation charter), recorded in the Company’s Social Participation’s Book, and executed in a public document to be registered in the Commercial Registry in order to take effect with third parties. The current partners will have a right of first refusal to acquire the social participations during the period of 15 days prior to any third party acquiring same.

In a Corporation the transfer must be recorded in the shareholders’ book and shares must be indorsed in favor of the buyer. In some cases the Corporation’s bylaws or incorporation charter might require that the shareholder wishing to transfer shares notify, or request authorization from, the board of directors.

These restrictions must always be taken into consideration when there is a transfer of social participation or shares.

PRE-AGREEMENT

It is customary for parties of a merger and acquisition to negotiate and execute a letter of intent, also known as “*Memorandum of Understanding*”. The letter of intent is not regulated by either the Code of Commerce or the Civil Code. It has no legal or binding effect as it is considered only a manifestation of the intentions of the parties for the proposed transaction. On a practical note, these documents should contain the identification particulars of the parties, a statement of the intention to negotiate, a summary of

the steps carried out to date, their positioning, an explanation of transaction they intend to carry out, the terms and conditions to be met or steps to be taken to achieve an understanding, the objectives sought and/or the time in which they must be achieved. It is recommended, due to the risk associated that this type of agreement might be interpreted as an offer or option under the Commerce Code, to include a “non-binding” clause stating that the document is not legally binding and is not an offer or an option. Binding clauses can be included to give certainty to the negotiations, such as confidentiality or exclusivity clauses or clauses restricting parallel negotiations, among others.

DUE DILIGENCE PROCESS

It is very common practice for the parties to agree in the letter of intent to carry out, before perfecting the purchase transaction, usually through the purchaser’s advisors and at the purchaser’s expense, a due diligence process, which will enable the purchaser, among other things: (i) to identify the risks and contingencies associated with the target company (or its assets); (ii) to obtain elements to determine the value of the target to be acquired; (iii) to obtain valuable information for the negotiation; (iv) to identify potential synergies; (v) to determine the structure of the transaction; (vi) to determine the solidity of the proposed investment; and (vii) to determine the level of security that will need to be requested from the vendors in the purchase agreement.

Generally speaking, a due diligence process for a share purchase is usually more complex and involves a greater amount of research than for an asset purchase. In asset transfers it is common practice in Honduras to study how the ownership of the various assets can or must be transferred. For example, for the transfer of real estate, intellectual property or administrative concessions it will be necessary to obtain a public document of transfer, for registration as applicable. In this case, the purchaser will also analyze whether the agreements and the obligations and rights under those agreements can be assigned with or without the consent of the other party.

In the case of the transfer of shares, it is important for the review of agreements to include an examination of change of control clauses. These clauses usually allow the other party to terminate the agreement or amend its terms and conditions if, for example, the shareholder or shareholders holding the majority of the shares in a company cease to hold them. If such a clause exists, the purchaser will have to consider whether to obtain the prior acceptance of the other party or to include the third-party’s consent in the purchase agreement as a condition precedent to the transaction.

The result of the due diligence process will necessarily have an impact on the most characteristic clauses of the purchase agreement, the representations and warranties that the purchaser requests from the vendor.

ANTITRUST CONCENTRATION CONTROL ISSUES TO BE TAKEN INTO ACCOUNT IN A MERGER OR ACQUISITION TRANSACTION

The Honduran Law for the Defence and Promotion of Competition (“LDPC”) provides that foreign entities are subject to the LDPC when their activities, agreements, practices, covenants, arrangements or business acts have effect in Honduras. Based on the strict interpretation of this provision, the conservative and advisable approach is to provide the notification for all transactions resulting in a change in control of a Honduran entity or being carried out with a business in the country. Article 13 of the LDPC provides the obligation for economic agents to notify of the economic concentration of any transaction that causes a change in control. This notification has to be filed before the concentration has any direct effect or any legal or material effect in the Honduran territory, making the agents subject to fines in case of breach of this obligation.

ACQUISITION AGREEMENT

Regardless of the structure of the transaction, acquisition agreements have the following five common and very important features which are examined in this article: (a) representations and warranties; (b) pre-closing covenants; (c) conditions precedent to closing; (d) indemnification; and, (e) dispute resolution.

(a) Representations and Warranties:

The seller and the buyer will make representations and warranties to each other in the acquisition agreement. The seller's representations and warranties typically make up the largest part of the acquisition agreement. Representations and warranties serve three important purposes. First, they are informational. The seller's representations and warranties, coupled with the buyer's due diligence, enable the buyer to learn as much as possible about the seller's business, prior to signing the definitive acquisition agreement. Second, they are protective. The seller's representations and warranties provide a mechanism for the buyer to walk away from, or possibly renegotiate the terms of, the acquisition, if the buyer discovers facts that are contrary to the representations and warranties between the signing and the closing. Third, they are supportive. The seller's representations and warranties provide the framework for the seller's indemnification obligations to the buyer after the closing. As a guarantee for the representations and warranties, the execution of escrow agreements is the general rule. The most common representations and warranties include: (a) corporate organization, authority, and capitalization; (b) assets; (c) liabilities; (d) financial statements; (e) taxes; (f) contracts, leases, and other commitments; (g) employment matters; (h) compliance with laws and litigation; (i) product liability; and (j) environmental protection.

(b) Post Closing Covenants:

Typical negative covenants (covenants that restrict the seller from taking certain actions prior to the closing, without the buyer's prior consent) include: (a) not changing accounting methods or practices; (b) not entering into transactions or incurring liabilities outside the ordinary course of business or in excess of certain amounts; (c) not paying dividends or making other distributions to stockholders; (d) not amending or terminating contracts; (e) not making capital expenditures; (f) not transferring assets; (g) not releasing claims or waiving rights; and (h) not doing anything that would make the seller's representations and warranties untrue.

Typical affirmative covenants (covenants that obligate the seller or the buyer to take certain actions prior to the closing) include: (a) allowing the buyer full access to the seller's books, records, and other properties; (b) obtaining the necessary board and stockholder approvals; (c) obtaining the necessary third party consents; and (d) making the required governmental filings and obtaining the required governmental approvals.

(c) Conditions Precedent to Closing:

All merger and acquisition agreements provide that, as a condition to closing, the representations and warranties of the parties must be true and correct at the closing, and that the pre-closing covenants have been performed or fulfilled prior to the closing.

This is confirmed by each party delivering to the other party a written certificate to that effect. Other typical conditions to closing include: (a) receipt of the necessary third party consents; (b) receipt of the necessary governmental approvals; (c) receipt of legal opinions and other closing documents; (d) receipt of certain financial statements or the achievement of certain financial milestones; (e) receipt of employment or non-competition agreements from key employees; and (f) satisfactory completion of the buyer's due diligence of the target's business.

(d) Indemnification:

First, the seller will try to limit the time period after the closing for which it has indemnification obligations. In theory, this time period should be based upon the reasonable period of time within which the buyer,

through reasonable diligence, will discover any breaches or misrepresentations or, if applicable, the time period within which a third party would make its claim. In practice, the parties generally agree on a period of one to three years after the closing. Exceptions may be made for environmental and tax liabilities, for which the time period may be the applicable statute of limitations. Second, the seller will try to impose a cap on the total amount of its indemnification liability. Many sellers try to cap their liability at an amount less than the total purchase price. Many buyers will agree to a cap equal to the total purchase price. If the seller's business is "clean," the risk to the buyer in agreeing to an indemnification cap may be small. Third, the seller will try to negotiate a "basket" or a "deductible" on its indemnification obligations in order to eliminate small indemnification claims.

(e) Dispute resolution:

Arbitration is now the most common dispute resolution method established in all acquisition documents. The arbitration is usually set outside of Honduras if a foreign acquirer is involved, although parties are more and more relying on arbitration centers in Honduras as the choice of forum.

LAW FOR THE GENERATION OF EMPLOYMENT, PROMOTION OF THE ENTREPRENEURIAL INITIATIVE, FORMALIZATION OF BUSINESSES ,AND PROTECTION OF THE RIGHTS OF INVESTORS.

This Law was approved by the National Congress with the objective of facilitating the formalization of commercial activities and encouraging the development of entrepreneurship. It establishes a corporate regime that is applicable to all types of companies recognized by the Commercial Code, except for those whose purpose is the development of activities subject to special regulations and supervision by the State (Institutions of the Financial System, for example). It establishes regulations regarding corporate modifications such as mergers, divisions, capital increases and others.

The new regime establishes some significant changes in relation to the constitution of mercantile companies and their corporate functioning; first, if we refer to article 3 of the mentioned law we can observe that the companies created under this regime must be constituted through a unique special form, which will be created by the Mercantile Registry, which must be available in physical format or in electronic format. The registration must be done in a unique electronic register of national level. The registrar will receive the registration form and only verify that the purpose of the company is valid and legal, which will subsequently assign the registration number, digitize it and save it in the database of the Mercantile Registry. **This form will be considered the articles of incorporation of the company. Likewise, according to article 12 of the Law, modifications, transformations, mergers, divisions, capital increases, or other acts, may also be carried out through this form. It is understood that the constitution, modifications, transformations, mergers, divisions, and capital increases, by means of forms, will only proceed in the event that the Company was constituted under the regime established in this Law.**

Another relevant change is the possibility that companies created under this regime may have a single partner, according to article 5 of the Law. This article also states that the establishment of minimum capital will be voluntary and that companies with no minimum capital with more than one partner or shareholder must indicate the percentages (or shares) of each partner or shareholder. This Law also contains changes in relation to the way in which the corporate governance of the companies incorporated under this regime should be managed; for example, article 6 establishes that the companies incorporated under this regime may control the shareholders' meetings or the acts of their administrative organs in electronic format, and in addition, no authorization or notification from any central, departmental or municipal government authority of the company's social and accounting books will be required. Likewise, the same article establishes the possibility of recording the meetings in video. In these cases it will not be necessary to keep shareholders' or board of directors' minutes books.

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