Nicaragua
Negotiated M&A Guide
Corporate and M&A Law Committee

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INTRODUCTION

(a) Definitions of Mergers and Acquisitions:

A “merger” is the absorption of one company by another. The company that makes the purchase retains its name and identity, at once appropriates all assets and liabilities of the acquired company. After the merger, the acquired company ceases to exist as a separate business entity. One of the basic reasons for a merger is that a combined company can operate more efficiently than two separate companies. Through a merger, a company can gain greater operational efficiency in various areas or functions.

A second way of acquiring another company is to buy its shares with voting rights giving in exchange cash, shares and other securities. The purchase procedure usually begins with a private offering made by the administration of a company to another. At some point, the offer will be made directly by the shareholders of the company to sell, what can be achieved through a direct offer. The offer is communicated to shareholders of the company set as a target for acquisition by public announcements.

Also a company may acquire another company buying the whole assets. The Asset acquisition involves the transfer of title. The procedures used for the transfer of assets can be costly.

A major reason for the acquisitions is that a combined company can generate more revenue than two separate companies. The increases may come from marketing gains, strategic benefits or market power.

(b) M&A in the Central America Context:

Central America is a region which has an estimated population for 2016 of over 44.5 million. CEPAL predicts an increase of the Gross Domestic Product of 4.5% in 2017 for Central America and Dominican Republic.

In 2006, Dominican Republic, Costa Rica, Honduras, Guatemala, El Salvador and Nicaragua signed and ratified a Free Trade Agreement with the USA (DR- CAFTA). Additionally, in 2011 the Central American countries signed a Free Trade Agreement with Mexico and later in 2012, Central America entered into the Association Agreement with the European Union; consequently Central America expanded its opportunities of investment and integration and many acquisitions took place.

One example of acquisitions in Central America was when General Electric Consumer Finance acquired BAC Group; this Group was founded in Nicaragua in 1952. It is a regional banking network with presence in Central America and Mexico, with 178 branches. Besides the Bank, BAC group is the owner of a Credit Card issuer company and a brokerage company. In 2008 it had approximately US$ 7.5 Billion in Assets, US$ 5.2 Billion in Credit Portfolio and US$ 4.7 Billion in Deposits.

In 2005, GE Consumer Finance acquired 49.99% of the shares of BAC International Group and in 2009 it acquired another 25% of the Shares of BAC Group, reaching a 75% ownership. The amount of the transaction was an estimate of 1,400 Millions of dollars for the purchase of the 75% of the shares.

Another example of acquisitions in the region occurred when Citigroup acquired Grupo Financiero Uno (GFU). This Group was founded in Nicaragua in 1991 being the main Credit Card issuer in Central America.

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3 Id.
America. It was a regional Bank with offices in Guatemala, Honduras, El Salvador, Costa Rica, Panama and Nicaragua, with 75 branches. GFU was also formed by a Credit Card issuer and a brokerage firm. In 2006, Citigroup acquired all the companies that formed GFU. Now Grupo Financiero Uno is now known as Citibank in all Central America. The value of the transaction was estimated in US$ 1.5 billion.

(c) **Latest Trends:**

The latest trends of M&A in Central America have had as target different sectors that include: energy, banking and insurance, cement, paints, mining, transportation, construction, among others.

The banking sector is one of the most competitive and therefore with more activity in Central America. In addition to the mergers and acquisitions referred above, in 2012, HBSC Holdings Plc sold its assets in Costa Rica, El Salvador and Honduras to Banco Davivienda SA from Colombia for US$ 801 million in cash, representing, approximately 4.6% of the total assets of the South American entity. In December, 2010 Grupo Aval which is the largest financial group of Colombia, purchased 100% of the shares of the financial group of Banco de América Central - Credomatic, with banking branches and credit card offices in the entire region.

In 2009, Wal Mart - Mexico acquired 100% of the shares of Wal Mart - Central America, owned by Wal Mart Stores Inc from the United States (51%) and minority investors in the region (49%, among those stand "CSU" from Costa Rica and the Guatemalan Company "La Fragua"). The transaction contemplated the payment in cash of $ 110 million and the sale of shares.

In 2013, "Cementos ARGOS" from Colombia, expanded its presence in Central America with the purchase of 53% of "Lafarge" of Honduras, for the amount of US$ 305.4 million. Also, the Peruvian entrepreneur group "Ferrycorp SA" whose principal activity is the sale of capital goods and related services, increased its presence in Central America through the acquisition of 100% of the Nicaraguan enterprise Mercalsa's stock for the amount of $ 5.2 million.

On the other hand, Bancolombia SA one of the major holdings in South America, agreed through its subsidiary Bancolombia Panama SA, the acquisition of 40% of the Financial Group "Agromercantil SA" with operations in Guatemala for US$ 216 million dollars. In the paint industry, the World Investment Group SA reached an agreement with the American company HB Fuller and its subsidiary Chemical Supply Corporation for the Kativo Group acquisition, one of the leading producers and distributors of paint in Central America for a total sum of US$ 120 million.

Also in 2013, the main gold mining company in Colombia, Mineros SA, bought 90% of the shares of the Nicaraguan mining Company HEMCO, which operates a mine in Bonanza, in the Atlantic Autonomous Region (Caribbean) RAAN. HEMCO’s acquisition coincided perfectly with the good year that the export of gold had, as the main outside product sales of Nicaragua, with a bill of US$109.5 million, according to the Center for Exports, CETREX.

In addition to the above-mentioned acquisitions, there were significant acquisitive moves in the oil, energy and telecommunication sectors. Among them, was the purchase of 100% of the Guatemalan company "Central Electricity Distribution SA II" by Public Enterprises Medellin ESP; this transaction was made for US$ 605 million.

In the oil sector, "Petróleos DELTA" subsidiary of the General Investment Company SA of Panama acquired in December 2010, 100% of the shares of Shell - Costa Rica, in a transaction whose amount was not revealed. In the pharmaceutical sector, the Central Pharmaceutical Corporation SA (CEFA) closed negotiations to sell 50% of its shares to the Chilean pharmaceutical group SOCOFAR SA. The sale responded to CEFA’s strategic decision to seek a partner that allowed it to acquire knowledge, improve its business practices and promote its growth. Meanwhile, SOCOFAR took its first steps towards internationalization entering in the Central American market.
Finally, in the telecommunications industry, the Mexican company “América Movil” bought Digicel Limited Group’s operations in Honduras and El Salvador, in exchange of cash and its operations in Jamaica. The amount of the transaction was not disclosed to the public.

**(d) Applicable corporate and other legislation in Nicaragua:**

Nicaraguan Laws briefly regulate mergers of companies. Mergers are basically regulated in the Commerce Code and in the Law on Competition Promotion.

- The Commerce Code of Nicaragua establishes the following procedure for a merger:

  In order the merger can be done, a previous agreement from each of the companies is necessary. The merger will take effect only after three months from the publication of the respective agreement.

  During these three months, any creditor of the companies that want to enter into the merger may oppose to it; the opposition suspends the completion of the merger until it is resolved by courts.

  After the expiration of the previous term or when other requirements are fulfilled, the merger will be finally completed and the incorporated company will assume all rights and obligations of all extinct corporations.

  Companies which Bylaws should be subject to the approval of the Executive Branch, require the same approval to merge.

- Law No. 601 “Law on Competition Promotion, Laws No. 668 and 773 of amendments to the Law on Competition Promotion, and “Decree No. 79-2006 Regulation of the Law on Competition Promotion”

The Law on Competition Promotion defines and regulates Concentrations, which occur when economic agents that have been independent sign an agreement of merger, acquisition, consolidation, integration or combination of their business in whole or in part, by ceasing of being independent.

Types of Concentrations:

1) Vertical: When the economic agents involved are part of the different stages of production process, from the manufacture of raw material, processing, distribution and marketing.

2) Horizontal: When the economic agents are positioned on the same level of production or marketing.

3) Clusters Concentrations: When the economic agents that are intended to concentrate, participate in various unrelated markets, in order to expand its action scope.

This Law also regulates the Nicaragua Antitrust Authority (PROCOMPETENCIA) that has the power to authorize all or part of concentrations or to reject them, when they prevent or limit competition.

**STRUCTURE OF THE TRANSACTION**

There is virtually an infinite number of ways in which a corporate merger or acquisition may be structured. There are probably as many potential deal structures as there are qualified and creative transactional lawyers and investment bankers.

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6 Article 263-268.

The goal is not to create the most complicated, but rather to create a structure which fairly reflects the goals and objectives of the buyer and seller. Naturally, not all of the objectives of each party will be met each time; there will almost always be a degree of negotiation and compromise.

Virtually all structures, even the most complex, are at their roots basically either mergers or acquisitions, including the purchase or consolidation of either stock or assets. The creativity often comes in structuring the deal to achieve a particular tax or strategic result or to accommodate a multi-step or multi-party transaction.

(a) Structuring the Deal: Stock vs. Asset Transactions:

Probably the most fundamental issue in structuring the acquisition of a target company is whether the transaction will take the form of an asset vs. stock purchase.

Each form has its respective advantages and disadvantages, depending on the facts and circumstances surrounding each transaction. In Nicaragua as in the United States the buyer and seller should consider the following factors, such as: Tax issues, Nontransferable rights or assets, Corporate name and goodwill of the company, corporation's liabilities, unemployment or workers' compensation insurance ratings, complexity of the transaction, bargaining agreement, accounting methods, licenses and permits, etc.

The purchase of stock may be the most common transaction in Nicaragua because it can be less complex.

(b) One step versus multi step transactions:

Another key issue regarding the structure of the deal is whether the entire transaction will be completed in one step or whether it will occur over a series of steps. The parties may want to get to know each other better before considering a full-blown merger or there may be some contingencies affecting the value of the company which are driving the buyer, or even the seller, to want to slow things down and consider a preliminary transaction as the first step.

It is also plausible that the Seller believes that the long-term value of the company may be much higher.

Even the seller may have certain reservations about the buyer or want to see certain contingencies met before it commits to selling 100% of its business. The buyer may be waiting for some key third party approval or event to take place, before which the seller is reluctant to commit, such as the buyer being in the process of filing for approval of an initial public offering (IPO) of its securities.

If these securities are to serve as part of the seller's compensation, then it may be wise to wait to ensure that there will be a secondary market (and hence liquidity) for the shares before moving forward. In such cases, the parties would enter into a letter of intent but there would typically be a clause that allows the seller to walk away from the deal if the offering is unsuccessful.

Some transactions are multi-staged for strategic reasons and some may be structured to be one stage with the possibility of being multi-staged if certain post-closing contingencies are not met.

(c) Method of Payment:

The way in which the seller will be paid is quite clearly one of the most important aspects of structuring the deal. The method of payment for the acquisition of stock or assets ordinarily involves a balancing of business and tax considerations. Often a particular fact or set of circumstances will outweigh the others and determine the method of payment. Although the personal, strategic and tax needs of all parties must

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8 Georgetown University Course of Mergers & Acquisitions. Professor Andrew Shearman.
be considered, there are a wide variety of forms of payment which should be considered before a final decision is determined.

These include cash, marketable securities, parcels of real estate, the rights to intangible assets (licenses, franchises, etc.), secured and unsecured promissory notes, the common and preferred securities of the purchaser (or their affiliates) (and often with the promise that these securities will one day be publicly-traded), earn-outs, consulting and employment agreements, royalty and license agreements or even the exchange of another business. All of these tools should be considered in structuring the elements of the purchase price.

PRE AGREEMENT

(a) Letter of Intent:

Letter of Intent ("LOI") resembles written contracts, but is usually not binding on the parties. Some LOIs, however, contain provisions that are binding, such as a covenant to negotiate in good faith, or a "stand-still" or "no-shop" provision promising exclusive rights to negotiate.

The LOI may also be referred to as a memorandum of understanding (MOU), term sheet or discussion sheet.

There is however a specific difference between an LOI and MOU, whereby an LOI represents the intent of one party to the other and does not need to be signed by both parties. In contrast, an MOU is an agreement between two or more parties, which should be signed by all parties to be valid.

The LOI is typically used in transactions in Nicaragua. The purposes of an LOI may be:

- to clarify the key points of a complex transaction for the convenience of the parties
- to declare officially that the parties are currently negotiating, as in a merger or acquisition proposal
- to provide safeguards in case a deal collapses during negotiation

The better the LOI, the better will be the first draft of the definitive document of the transaction, so this a very important part of the transaction.

(b) Due Diligence after the Pre-Agreements:

Due diligence in M&A transactions refers to the process through which a potential acquirer evaluates a target company or its assets for acquisition.

The due diligence involves the review and analysis of several aspects of the company such as corporate, regulatory, tax, social and environmental, labor, litigation, real estate, etc.

Some of the conditions established in the LOI such as price and structure of the deal may be modified after the due diligence results.

(c) Lock-up (or voting) agreements with major shareholders:

According to our law a merger has to be preceded by an Agreement of the General Meeting of Shareholders as previously stated.
Our Code of commerce in its Article 262 establishes that: “Unless provided in the By-Laws, to approve the merger is always required three quarters of the social capital and the votes of the present members who represent half of the capital.”

**ACQUISITION AGREEMENT**

As stated before, the acquisition of a business may be structured in virtually infinite ways, including and assets sale, a stock sale, or a merger. The final Agreement will depend on several factors of the transaction: legal, business, taxes, accounting, etc. However, there are sections that we can identify as common in the Agreements, which are:

1. Preamble: The Parties and the Recitals
2. Purchase and Sale
3. The Closing
4. Seller’s Representations and Warranties
5. Purchaser’s Representation
6. Covenants
7. Conditions precedent
8. Termination
9. Indemnification

(a) **Holdback and escrows:**

The options for escrow and holdback are available in Nicaragua. Nicaraguan Banks are authorized to perform these operations and arrangements for both agreements could be negotiated by the parties.

(b) **Representations and Warranties:**

Like acquisition agreements in the United States, the seller and the buyer will make representations and warranties to the other. Representations and warranties serve as mechanism of disclosure for the seller and also they allocate the risks between seller and buyer. It is very important to tailor the representations and warranties to the particular business and transaction. However, the most common representations and warranties include:

   (a) Corporate organization; subsidiaries and other ownership interests
   
   (b) Authorization
   
   (c) Capitalization of target and subsidiaries
   
   (d) Financial Statements and projections
   
   (e) Absence of undisclosed liabilities
   
   (f) Most recent inventory
Regarding survival of representations and warranties, usually the survival period is between 12 and 24 months, depending heavily on the results of the due diligence process regarding the target’s business.

(c) Covenants of the buyer and seller:

Pre-closing covenants, or promises to do something, or not do something, are a major feature of merger and acquisition agreements.

Typical pre-closing covenants include that the seller will:

(a) conduct the business in the ordinary course without incurring any unusual liabilities.

(b) promptly advise the buyer of any proposal for the acquisition of any stock, or all or substantially all of the assets or business or any portion thereof of the target or any subsidiary.

(c) not do anything that would make the seller’s representations untrue.

(d) give to the buyer additional financial statements and summaries of account receivable.

(e) obtain third parties orders and consents.

(f) make the required governmental filings and obtain the required governmental approvals.

Regarding (f), Nicaraguan antitrust legislation requires that mergers and acquisitions shall be notified to and approved by PROCOMPETENCIA (the antitrust authority) if:

(a) as result of the merger or acquisition, the market share obtained is 25% or more of the relevant market.

(b) the firms involved have a gross combined income higher than approximately US$78 million.

The request for authorization shall be made before the merger or acquisition. PROCOMPETENCIA has the power to reverse a merger or acquisition executed without the due authorization. The de-merger could be partial or total.
In addition to the above mentioned, PROCOMPETENCIA has the power to sanction (individually or jointly) the companies participating in a merger or acquisition. The penalty for lack of notification goes from 100 to 600 minimum wages, which represents from US$15,400.00 to US$ 92,400.00.

Regarding post-closing covenants, the typical are:

(a) cooperation between the parties
(b) maintenance of records relating pre-closing operations
(c) non-competition covenants
(d) agreements not to solicit employees, consultants, agents or contractors
(e) covenants regarding purchase price allocations

(d) **Conditions of closing of the buyer and seller:**

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

Other typical conditions to closing include:

(a) proof of the necessary third party consents
(b) proof of the necessary governmental approvals
(c) receipt of certain financial statements
(d) receipt of non-competition agreements from key employees.

(e) **Indemnification provisions:**

Indemnification provisions typically address breaches of the representations and warranties or covenants that are discovered after closing. These provisions are heavily negotiated among the parties, with the most important issues being: the limit of the period of time during which the seller has indemnification obligations; the imposition of a cap on the total amount of the indemnification liability; and the imposition of a “basket” or a “deductible” of seller’s indemnification obligation in order to eliminate small indemnification claims.

(f) **Dispute Resolution:**

In Nicaragua the methods of dispute resolution are litigation, arbitration, mediation, or administrative claims.

Mediation and Arbitration are regulated in Law 540 “Law on Mediation and Arbitration” which establishes a special procedure to resolve any kind of dispute or claims, provided the parties have both agreed to submit their dispute to this procedure. If the parties agree, disputes may be resolved by procedures established by foreign law.

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