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# **Venezuela**

## **Negotiated M&A Guide**

Corporate and M&A Law Committee

### **Contact**

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## 1. INTRODUCTION

In Venezuela there are very few regulations relating specifically to business combinations for non-regulated sectors. Therefore, besides the Antitrust Law, the most relevant statutes are the Commercial Code, Capital Markets Law and Rules on public tender offers, exchange offers and takeovers of companies which publicly trade their shares or rights over such shares (hereinafter, the “Tender Offer Rules”).

Business combinations that occur in sectors such as banking, insurance and telecoms, are subject to specific regulations set forth in statutes that regulate such activities. Moreover, in the case of telecoms, as operators that use the radioelectric spectrum require a concession from the State, such agreement may establish specific regulations for merging such companies.

Likewise, in Venezuela, the oil and gas sector, as well as the electric sector are strongly regulated and therefore, the laws that rule such sectors set forth specific regulation for business combinations.

In any event, local professional advice is strongly recommended in carrying out an M&A transaction, as many local formalities ought to be met and many forms may be adopted in pursuing this kind of transactions.

## 2. STRUCTURE OF THE TRANSACTION

Business combinations may be structured in Venezuela in a wide variety of forms. Business combinations encompass not only the amalgamation of two or more corporations in which one of the corporations survives and the other disappears, or the consolidation wherein all corporations terminate their existence and become part of a new one (“Regular Mergers”), but also, the absorption of one business or firm into another (“Irregular Mergers”). The former include the (i) merger by absorption and the ii) merger by incorporation; whereas the latter include transactions such as the (v) sale of business venture; (x) stock mergers; (y) incorporation of a holding company and the (z) liquidation of a subsidiary.

The preference in adopting any of the above structures depends on the advantages that each particular situation will offer to the parties. For instance, one of the most important considerations in this kind of transaction is tax exposure of the selected structure. Therefore, parties would rather select the most tax-efficient structure, provided that it would eventually allow the acquiring party to control the surviving company. In any event, in general terms, the above structures may be defined as in the following sections.

### a. REGULAR MERGERS

Regular mergers include (i) merger by absorption and ii) merger by incorporation. These two types of transactions are most commonly known as mergers, but do not include all options for business combinations.

In regular mergers, the shareholders of each company must agree with the merger. It requires a shareholders meeting. If the bylaws of the company do not establish otherwise, such meeting will be valid with the presence of at least three quarters of the voting rights and the decision must be taken with a majority of the voting rights represented in the meeting.

Once the shareholders of each company have agreed to the merger, the minutes of both entities' shareholders meetings ought to be registered with the Mercantile Registry and published, along with a copy of the merger agreement.

Under Article 345 of the Venezuelan Commercial Code, the merger will not be in force, until the next three months following the publication of the merger agreement, unless it is evident that all social debts are paid or that the merger is agreed to by all companies' creditors. Within such

period, any creditor of either company involved in the merger may oppose the merger, and the merger will not take place until a judgment rejects such opposition. Nevertheless, we believe that if the company pays the opposing creditor's debt in full, the merger will not be suspended.

The surviving company will assume all assets and liabilities of the preexisting companies, including government licenses, without any tax consequences.

Shareholders of the disappearing corporation will receive in exchange, shares of the surviving corporation.

- *Merger by absorption*: A merger by absorption occurs when one of the existing companies dissolves and the surviving company assumes all its assets and liabilities. Normally, in this case, the shareholders of the company that disappears receive shares of the surviving company.

- *Merger by incorporation*: A merger by incorporation occurs when two existing companies dissolve and a new company assumes the assets and liabilities of both. Normally, in this case, the shareholders of the two companies receive shares of the new corporation.

#### b. IRREGULAR MERGERS

Irregular mergers include any structure that would eventually allow the combination of two or more previously existing businesses. It commonly includes the following forms of transactions: sale of going concern; stock mergers; incorporation of a holding company and the liquidation of a subsidiary.

- *Sale of a going concern*: The company to be absorbed (X), transfers all its assets and liabilities to the surviving company (Y).

The sale of a going business must meet the following requirements: (i) a publication in the newspapers informing the public about the projected sale by X of its business to Y, (ii) ten days later a second publication must be made, (iii) after ten days a third notice must be published and (iv) the assignment agreement must be registered with the Mercantile Registry. If the above requirements are not met, X and Y will be jointly and severally liable *vis-à-vis* those creditors of X which have made transactions with X before the sale of the business to Y. Y may also be held liable *vis-à-vis* those creditors of X which have requested, between publications, payment of the amount due to them.

The asset transfer from X to Y is considered to be a taxable event. For the purposes of calculating the income tax, the gain to be recognized will be limited to the difference between the historical cost of the assets, including normal yearly inflation adjustments, and the price paid by Y.

In case of transfers of real estate property, if any, seller advance a small percentage of tax based upon the value assigned to the real estate property. Such advance may be credited to the income tax payable at the end of the fiscal period of the seller. The advance payment must be paid prior to the execution of the real estate purchase agreement. Otherwise, the Notary and the Register will not accept the document. Y, as buyer of the property, must also pay a transfer tax (real property registry duties) calculated upon the price assigned to the real property.

Likewise, an additional stamp tax will apply (commercial registry duties).

Regarding the value added tax, it would not be applicable to transfers of real estate, but this tax would be applicable to transfers of inventory and other movable goods.

Government approvals, concessions or licenses obtained by X before the sale of the going concern may have to be requested again by Y. However, in general, government approvals do not require a separate act of transfer.

- *Stock merger*: Transaction involving the purchase by one company of the stock of another company.

Generally, the target company will not share its liabilities with the acquiring company because it is a separate entity.

Unless particular rules that may prevent the transfer or revoke a license due to transfer of control, government approvals shall subsist any such transfer of shares.

A withholding tax may apply on the price of the stock transfer, as an advance payment of the seller on the general income tax for the fiscal year in which the sale takes place.

The transfer is subject to general income tax. For the purposes of calculating the income tax, the gain to be recognized will be limited to the difference between the historical cost of the stock, and the price paid by the acquiring entity. The tax withheld may be credited to the income tax assessed as explained before.

However, if the subject company is listed in the stock exchange, a 1% withholding tax will be applicable as a definitive tax. No additional income tax will be levied.

- *Incorporation of a holding company*: Transaction involving the incorporation of a holding company, which will purchase the stock of a particular entity or a group of companies and becomes its parent.

The consequences and effects are similar to the stock merger.

- *Liquidation of a subsidiary*: Once the parent company takes control over its subsidiaries, such subsidiaries may be liquidated. If wholly owned, the parent company will receive all the liquidated company's assets, as payment of its stock contribution.

This is not a proper form of corporate amalgamation, but the end result is that the parent company will assume all the liquidated entity's assets.

For the liquidation of a subsidiary, the parent company shall cause the liquidating subsidiary to pay all its debts; the remaining assets will then be transferred to the parent company.

Because of the extinction of the entity, all government approvals and fiscal benefits will be lost at liquidation.

### 3. PRE-AGREEMENT

The stage prior to the agreement consists in a number of preliminary understandings and acts that prepare the parties to eventually complete the transaction.

As in many other jurisdictions, in Venezuela a business combination will begin with the negotiation and agreement on the general and broad terms that will govern the process to close the transaction. Such broad terms will be included in a memorandum of understanding or letter of intent signed by the parties. Said memorandum of understanding or letter of intent are usually not binding.

The other recommended or usual step is to conduct a due diligence on the target business.

Finally any previous filing, notification or permit shall be considered, including whether the proposed transaction would generate an effect of restricting free competition.

a. DECLARATION OF INTENT

Letters of intent or memorandums of understanding are usually drafted as a broad declaration to clearly set the intent of the parties to complete a future transaction. Normally, this kind of document has no value as a binding contract between the parties. However, parties may be bound by its terms depending upon the real intention of the parties as reflected in the document.

Letters of intent or memorandums of understanding will begin by identifying the parties, a clear statement of the parties' intent to negotiate the future transaction and a description of such transaction and the conditions that ought to be met in order to close it. It should address the process and length of the due diligence process. Additionally, as during this stage parties may be sharing their proprietary information, this kind of document should contain provisions protecting confidentiality and prohibiting the parties to enter into similar agreements with other parties.

It is highly recommended to set a determined timeframe to close the transaction. Otherwise, the preliminary stage may take too long and the expectations of the parties may not be satisfied.

Letters of intent or memorandums of understanding are not specifically regulated by Venezuelan statutes. However, if drafted in a certain way, it may fall under the category of preparatory agreements. According to Venezuelan law, preparatory agreements are perfected contracts that the parties execute to formally promise to celebrate an agreed transaction in the future. However, depending on the drafting, the parties may not be bound to complete the offered transaction. Normally, the celebration of the agreed transaction is subject to the completion of certain conditions that ought to be met in order to enforce the agreed obligations.

In any event, it will depend on how the letter of intent is drafted in order to categorize it as: (i) a simple broad declaration of intent to complete a future transaction, (ii) a complete and full agreement; or (iii) a promise to complete a transaction if the conditions are met. The two latter categories will be deemed contracts and will be governed by the civil and commercial code. Any breach of the terms and conditions of said contracts will be deemed a breach of a contract and it may be tried accordingly.

b. DUE DILIGENCE

In view of the structures to complete a combination of businesses, if the surviving entity will assume any liabilities of the acquired enterprise, due diligence is highly recommended.

This process consists in a review of the targeted business in order to determine any possible risk or contingency associated with it. During this process, the acquiring party may obtain valuable information to appraise the targeted business, to set the most advantageous structure for the deal and to eventually manage the acquired business, determining the synergies with more detail.

The due diligence review usually encompasses commercial matters, real estate, employment law matters, taxes and compliance with regulations and public formalities, such as licenses and concessions.

The due diligence review usually starts immediately after signing the letter of intent and it begins with a submission of a checklist prepared by the acquirer, including a request for all the information that will be reviewed during the process. The target company will set-up a data room, establishing the rules for accessing the information contained therein. For accessing the information contained in the data room, the disclosing party will request a confidentiality commitment from the parties that will be reviewing the information.

c. PREVIOUS FILINGS

In general, in the case of stock transfers and if the target entity is a closely held company, in Venezuela there is no requirement for previous filing or authorizations, unless the business is within a regulated sector where specific statutes would apply, such as in the banking, insurance or telecoms industries.

In the case of the transfer of assets, no previous authorization or filing must be observed. However, in the case of a transfer of a going concern or a business venture, the purchase agreement must be filed with the commercial registry and then published in the press informing the public about the projected sale. Ten days later a second publication in the press must be made, and after ten days a third notice must be published in a newspaper. If these requirements are not met, the purchaser will be jointly liable vis-à-vis those creditors of the seller that have made transactions with it before the sale of the business. The purchaser may also be held liable vis-à-vis those creditors of the seller that have requested, between publications, payment of the amount due to them.

In any event, the purchaser will be liable vis-à-vis the tax administration up to the value of the business transferred for one year after the purchase.

d. COMPETITION LAW CONSIDERATIONS

Article 6 of the Venezuelan Competition Law establishes that if an economic concentration has the effect of restricting free competition, or results in a “dominant position” in all or part of the market, then the merger may be prohibited.

Additionally, the Venezuelan Competition Law provides for a procedure that allows the parties involved in an act of economic concentration to receive from the Venezuelan *Superintendencia para la Promoción y Protección de la Libre Competencia* (“Procompetencia”), in advance of undertaking such act, the authorization to perform a conduct which is, in principle, prohibited by the Competition Law. If Procompetencia later takes action against such act, the procedure has the effect of excepting the parties from fines.

An “economic concentration” is defined by the Law for the Promotion and Protection of Free Competition (the “Competition Law”) as a “direct or indirect acquisition ... of control over other undertakings, through the acquisition of shares, the contribution of capital or any other form of contractual or legal arrangement which has the effect of transferring control ...[to the acquiring entity].” If such “economic concentration” has the effect of restricting free competition in Venezuela, or results in a “dominant position” in all or part of the market, then the merger may be prohibited in Venezuela.

For the determination of free competition restricting effects, and “dominant position,” it is necessary to establish, first, the relevant market where the “economic concentration” is based. As in most competition laws in the world, we have two considerations in Venezuela to determine the relevant market: (a) the geographic market, and (b) the product market, which is not determined by the type of products included in such market, but by the possibility to substitute one product for another.

Even if there were no market share increase, as a result of the “economic concentration,” the “dominant position” may be established also if the resulting company has significant advantages over its competitors considering its size and economic, financial and technological importance.

Procompetencia has no power to object to mergers abroad. However, if there is any local effect of any such merger, Procompetencia may investigate, object to the concentration, and take the appropriate measures to avoid any adverse effects on competition in the local market (including divestiture).

#### 4. ACQUISITION AGREEMENT

There is no fixed standard for drafting acquisition agreements and it will depend on the selected transaction structure. However, Venezuela has a civil code system where many situations are already governed by written statutes and codes.

Moreover, there are certain provisions established by law that may not be amended by the parties and even if the parties agree otherwise, the statutory provision will prevail. This is mostly related to the liabilities of the parties involved in the transaction towards third parties.

As in any other transaction, an agreement in Venezuela starts by mentioning the signatory parties and the individuals that would have the capacity of representing them in such transaction. The individuals shall be sufficiently empowered to dispose the rights of the parties involved and that should be expressly mentioned in the heading of the document.

##### a. OBJECT OF THE TRANSACTION

This is the first clause in Venezuelan practice, as it clearly defines the intention of the parties and describes their main obligations within the transaction.

In the case of business combination transactions, it describes the object that it is being transferred, whether it is stocks or assets or a business venture or going concern. It should clearly state the situation of the object that is being transferred.

##### b. PRICE AND PAYMENT

After the object is duly defined, the price ought to be set by the parties and the way payment will be made, whether it is by giving money or shares of the surviving company.

If the transaction implies the payment of money, this clause will establish whether the payment will be made immediately or in several installments.

If the payment is deferred, it would normally provide for the application of interest and this clause should establish how to calculate such interest.

According to Venezuelan law, parties may agree to receive the payment in foreign exchange, but if such payment is made within Venezuela, the receiving party must remit the foreign exchange to the Central Bank, which will give domestic currency in exchange, calculated by the current official exchange rate. There has been a strong exchange control system in place in Venezuela since 2003.

##### c. CONDITIONS OF CLOSING OF THE BUYER AND SELLER

Once the object and price are duly set, the parties may usually establish a waiting period before actually transferring or closing the transaction, and the acquirer may not pay the entire amount until such waiting period is elapsed.

In general terms, we may identify the following waiting periods:

- In the case of the transfer of a business venture, as the agreement must be publicly disclosed as referred to above (see section 2.a), above), a 33-day period must elapse in order to complete the transfer of the going concern, considering that there is no opposition from the creditors of the seller. Otherwise, the opposition shall be solved or the credit paid in order to close the transaction.

- In the case of a regular merger, the Commercial Code establishes a 90-day period after publication in order to consider that the merger is duly completed. During such period, the creditors of the absorbed company may oppose the transaction and until such opposition is solved or the credit is paid, the merger will not be deemed to be closed.

d. REPRESENTATIONS AND WARRANTIES

This is another clause typically contained in agreements entered into by companies with foreign capital that is becoming more and more common in Venezuelan practice.

This kind of provisions extend the seller's liability to include any contingent claims or actions against the company for matters or circumstances occurred before closing but claimed after the company has been sold. However, usually the representations and warranties contained in this kind of provisions are ruled by written statutes.

In any event, including a representations and warranties provision in the agreement will give the parties a better level of certainty.

This kind of provisions usually refer to the following issues:

i. Capacity of the parties to enter into the agreement

The parties will represent and warrant that they are entitled to the object of the transaction and that the individuals signing the agreement have full capacity to enter into and complete the agreement.

ii. Situation of the object of the transaction

The parties will represent and warrant that the transfer of the assets does not violate any legal or governmental provision, agreement or contract and that they are free from any type of restriction, encumbrance and third-party claims.

If the object of the transaction is an already incorporated company, the seller will represent and warrant that the target company is duly organized and exists under the laws of its incorporation and that it is capable to conduct its business and that there is no resolution from the shareholders meeting or board of directors that has not been registered or that its current bylaws are the ones currently registered with the commercial registry.

Likewise, seller will represent and warrant that the actual financial situation of the company is duly represented in the financial statement submitted for the transaction.

iii. Licenses and concessions

In cases of stock transfers and regular mergers, usually licenses and concessions may be transferred. However, in the case of transferring assets or a going concern, it is very unlikely the licenses and concessions may be transferred; it will depend on the statutory regulations of such licenses and the particular terms and conditions of such licenses.

iv. Receivables and relevant agreements

This representation and warrant is quite important as it represent one of the most important assets of the acquired business. Not only the receivables, but the relevant

agreements with customers will assure the viability of the merger if the acquirer is seeking to increase its participation in the market.

Therefore, the seller will represent that receivables and agreements are lawful and binding.

v. Assets

The assets are part of the value of the acquired business. Therefore, the seller will represent and warrant that the assets described in the financial statement actually exist and that they are property of the acquired business.

vi. Intellectual property

Intellectual property rights represent part of the assets of the business to be acquired. Therefore, they are used to determine the value of the business.

Seller will represent and warrant that all trademarks used by the target company or the acquired business are its property and that they are duly registered and current. This is applicable to patents, utility models as well as any other form of intellectual property, including copyrighted works, too.

vii. Employment matters

Together with taxes, in Venezuela, this is one of the most important contingencies that an acquirer may assume in cases of business combinations, due to the acquirer's joint and severally liability that arises in a number of circumstances over situations occurred before the transaction.

Therefore, this is one of the most important representations and warranties that ought to be made by the seller, and it is basically assuring that it is in compliance with all the employment legislation, including individual and collective bargaining agreements.

viii. Taxes

In Venezuela, this is one of the items that represents major risk and contingency to the acquirer due to the number of circumstances where the acquirer will become jointly and severely liable with the seller towards the tax administration. Therefore, we recommend not just including the representation and warrant from the seller that all taxes have been duly and timely declared and paid, but creating an escrow or a trust that would somehow secure the acquirer that it would be paid in case of any tax contingency.

ix. Lawsuits

Seller will represent and warrant that there is no material lawsuit against the business that it would somehow affect its performance.

x. Misrepresentations

Seller will represent and warrant that none of the information supplied to the acquirer is inaccurate.

e. INDEMNIFICATION PROVISIONS

We recommend establishing in the document that the seller would hold the acquirer and the target company harmless from any contingency or loss as defined in its broader definition.

f. NON-COMPETE AND NO CONCURRENCE AGREEMENT

This is a very common provision in business combination agreements, as it will assure the acquirer that the seller will not compete against the surviving the entity, which it formerly managed and know.

However, this kind of provision must be quite specific in its geographical scope and shall establish a reasonable timeframe. Otherwise, it might be deemed an unlawful restriction of fair competition and may be declared null.

g. EMPLOYMENT LAW CONSIDERATIONS

If the employer is substituted, i.e., if the target entity does not subsist after the business combination, an employer substitution is deemed to occur and the change must be notified to the employee, the union and the local labor authorities. Each employee is granted a 30 day period to accept such substitution.

If the employee does not accept the substitution within such period, the employment relationship will be deemed terminated. In such a case, the employee will be entitled to receive indemnification as if the relationship was terminated without cause.

In any event, any substitution of employer will not affect the benefits received by the employee, and in case of mergers, the most favorable regime will be applicable to the employees of the amalgamated business.

h. DISPUTE RESOLUTION

Normally, parties select a jurisdiction that has a connection with the transaction and will have the agreement subject to the courts of such jurisdiction. However, it is not uncommon to find alternative dispute resolution methods agreed upon business combination transactions. Such clauses usually give a timeframe for negotiations between the parties and if the dispute is not solved, then the parties will submit the issue to arbitration. The most common is the arbitration chamber of the Caracas Chamber of Commerce and CEDCA, an arbitration center associated with the Venezuelan-American Chamber of Commerce.

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