
THE MERGERS & ACQUISITIONS REVIEW

SEVENTH EDITION

EDITORS

SIMON ROBINSON AND MARK ZERDIN

LAW BUSINESS RESEARCH

THE MERGERS & ACQUISITIONS REVIEW

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In presenting this seventh annual edition of *The Mergers & Acquisitions Review*, the publisher would like to extend warm and heartfelt thanks to editor Simon Robinson, who has recently retired from Slaughter and May. Simon has held the position of editor of *The Mergers & Acquisitions Review* since its inauguration seven years ago, and Simon and his partners at Slaughter and May have been instrumental in the success of The Law Reviews series. Thank you Simon.

The publisher would like to welcome Mark Zerdin, also a partner at Slaughter and May, as current and future editor of *The Mergers & Acquisitions Review*. We are delighted to have Mark on board, and we look forward to future editions in Mark's very capable editorial hands.

Gideon Robertson
Publisher, The Law Reviews
August 2013

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EDITOR'S PREFACE

This past year has seen some surprising twists and turns, not only in the mergers and acquisitions markets but also in the economic and political environments. November saw the re-election of Barack Obama, although this had less of an impact on the markets than an announcement by Ben Bernanke in May that the US Federal Reserve would consider a slowdown in its programme of quantitative easing. On the other side of the Pacific, Xi Jinping has outlined a new communist doctrine – the ‘Chinese dream’. The doctrine reflects the changing economic outlook in China where growth will be increasingly consumer rather than investment-led. A new political rhetoric has also emerged in Japan as Shinzo Abe, elected in a landslide December victory, seeks to reinvigorate the Japanese economy. Both rebrandings flirt with nationalist sentiment and the attitude of these two countries towards one another will continue to bear on the region’s business environment.

In Europe, despite an awkward Cypriot bailout, the sovereign debt crisis showed signs of stability and government bond yields are falling. Europe also improved its attractiveness in the eyes of investors and remains the largest destination for foreign direct investment. However, there has yet to be a return to growth. Investors seem split fairly evenly between those who believe Europe will emerge from the crisis in the next three years, and those who believe it will take five years or more. In any event, a return to the boom years is unlikely in the near future, particularly as the emerging markets see a relative slowdown. The IMF data for 2012 shows that the combined growth rate of India and China is at its lowest in over 20 years while global growth fell below 2.5 per cent in the second half of 2012. This global slowdown continues to pull M&A figures down making 2012 the fifth consecutive year in which deal values fell globally.

There are reasons for optimism though, particularly in the US market which has seen some substantial deals (the acquisitions of Heinz and Virgin Media being particular highlights). These deals have been made possible by the return of debt financing where the right deal can attract very favourable terms. Equities have also performed much more strongly over the past year. In May 2013 both the Dow Jones and the FTSE 100 hit record highs – validating to some extent the aggressive monetary policies pursued in

the US and the UK. Whether political will can start to lift the markets more broadly still remains to be seen.

I would like to thank the contributors for their support in producing the seventh edition of *The Mergers & Acquisitions Review*. I hope that the commentary in the following chapters will provide a richer understanding of the shape of the global markets, together with the challenges and opportunities facing market participants.

Mark Zerdin

Slaughter and May

London

August 2013

Chapter 22

ECUADOR

*Diego Pérez-Ordóñez*¹

I OVERVIEW OF M&A ACTIVITY

In recent years, Ecuador has become an important jurisdiction for M&A activity. Several factors have had a bearing on increasing and strengthening the industry. The regional component stands out in the first place: Latin America has been consolidated as an extremely attractive region for investments and for commercial activities – acquisitions of companies, purchases of assets or joint ventures or of other targets, for instance – mostly as a result of the stability of its economy and of its political regimes and a resurgence in the commodities and raw materials markets, compared with the economic difficulties prevailing in other regions. Since 2000 the United States dollar has been the country's legal tender; inflation is stable at rates of merely one digit; bank deposits have multiplied; interest rates have been unwavering; and consumption levels have also experienced substantial growth. In addition, after several years of fluctuation, mainly because of irregular governmental successions, the political situation in Ecuador is stable and economic policies remain firm.

All of the foregoing has resulted in a solid local industry, a growing middle class, diversification of consumption patterns and, hence, the appearance of new supplies of goods and services of varied types.

Three basic kinds of transactions take place in the Ecuadorean market:

- a* substantial global or regional transactions having repercussions in the local market such as when an international company invests in purchasing another company that, due to market-related issues, is already present in Ecuador. These kinds of transactions were more common a decade ago, prior to the stable period described above;

¹ Diego Pérez-Ordóñez is a partner at Pérez Bustamante & Ponce.

- b* international companies seeking to invest in Ecuador. Those transactions are the most common nowadays. They involve international companies, usually from the mid-market, that seek to purchase Ecuadorean assets or Ecuadorean companies particularly in areas such as the agricultural industry, fisheries, pharmaceuticals and the consumer sector. Substantial mining activity is expected in the next few years; and
- c* transactions among Ecuadorean companies. This is the least active in the market because Ecuador's entrepreneurial sector is just experiencing growth.

II GENERAL INTRODUCTION TO THE LEGAL FRAMEWORK FOR M&A

Mergers of commercial companies controlled by the Superintendency of Companies are regulated by the Law on Companies. According to corporate legislation, a merger can occur in two ways:

- a* if two or more companies join to create a new company that succeeds them in their rights and obligations (simple merger); or
- b* if one or more companies are taken over by another company that continues to exist (merger by takeover).

The procedure for a merger is as follows. In order to merge a company to result in a new company, it is first necessary to agree about the former's dissolution and afterwards to transfer all of its corporate assets in bulk to the new company. If the merger is the result of one or more companies having been taken over by an existing company, the latter must likewise acquire in bulk the assets of the company or companies taken over by means of a capital increase in the applicable amount.

In the case of merger by takeover, the company that takes over must approve the basis for the operation and a draft amendment to the by-laws at a special shareholders' meeting especially called for that purpose. The companies that will be absorbed or those that merge in order to create a third company must also approve the merger in the same manner (that is, by calling a shareholders' meeting).

The Superintendency of Companies must approve a public deed comprising the merger of commercial companies that, in order to take effect, must subsequently be published as an excerpt and then registered with the Mercantile Registry. The deed, according to the Law on Companies, must include the final balance sheet of the companies merged or taken over, the modifications to the by-laws resulting from the capital increase of the company that takes over, and the number of shares that will be delivered to each new shareholder.

Effects of a merger: The following are the effects of a merger of two or more companies, as the case may be:

- a* if a simple merger is involved, that is, if two or more companies are joined for the purposes of creating a new company, a new juridical person is created that succeeds the rights and obligations of the merged companies; and

- b* in the case of merger by takeover, the company that takes over will pay the liabilities of the company taken over and must assume the responsibilities inherent to a liquidator as regards the creditors of the company that is taken over.

From a taxation standpoint, the Tax Code specifies that purchasers of businesses or of companies will be responsible – as buyers or successors – for all the taxes that the transferor might owe and that are generated from the business of the company being transferred during the year when the transfer takes place and during two years previously. Liability is limited to the value of the assets. On the other hand, the Tax Code also provides that companies that substitute other companies will also be responsible as their purchasers or successors and must take charge of the assets and liabilities, in whole or in part, through a merger, transformation, takeover or otherwise. Such responsibility includes the taxes owed up to the date of whatever corporate action takes place.

Transfers of assets and liabilities occurring in mergers do not incur income tax, and the greater or lesser amount reflected in the value of the shares or share interests of the shareholders of the merged companies is not taxable or deductible. Assets (tangible or intangible) may be transferred at present value or at market value. Regarding this issue, the Superintendency of Companies has resolved that, on the basis of an expert appraisal, the market value of tangible or intangible assets must be determined by the shareholders' meeting that decides the merger.

i Acquisition by assignment of a business

Another form of acquisition – other than the merger varieties described above – is the sale of all the merchandise or goods of a tradesman. This is ruled by the Commercial Code. In practice, this system has been legally used to buy and sell all the assets and liabilities of a tradesman (i.e., an individual capable of entering into contracts who usually carries out commercial activities) or of a juridical person of a commercial character (i.e., a company controlled by the Superintendency of Companies) or of the branch of a foreign company.

It should be noted that in this case two or more juridical persons are not joined or one or more juridical persons are not taken over by a third party as in the case of mergers regulated by the Law on Companies. Rather, a commercial purchase and sale contract takes place as long as all the merchandise or goods of a tradesman are involved. According to Ecuador's professional practice, this system has been used mainly for sales of the assets and liabilities of the branch of a foreign company to a third party such as, for instance, a stock corporation or a limited liability company. This type of contract is used because of the impossibility of a classic merger since the branches of foreign companies do not have a capital shares divided into shares or share interests. Furthermore, branches of foreign companies are under the same legal regime as their parent company.

The only formality required for this type of contract is the execution of a public deed; otherwise the penalty is nullity. It is, therefore, unnecessary to register it with the Mercantile Registry.

From a taxation standpoint, the sale of a business where all assets and liabilities are transferred is not subject to the value added tax (VAT), the same as in mergers of companies.

ii Acquisition through transfer of shares or share interests

Another possibility for acquiring an Ecuadorean commercial company is through a transfer of shares or share interests. The capital of stock corporations, which are capital companies, is divided into shares of stock. On the other hand, the capital of limited liability companies and partnerships is divided into share interests.

Non-financial stock corporations are subject to the Law on Companies and are under the Superintendency of Companies' control. Their capital stock is divided into common, registered and indivisible shares. They can issue preferred shares amounting to 50 per cent of their subscribed capital. Preferred shares may confer special rights upon the company's liquidation or for profit distribution purposes, but they cannot pay fixed dividends or interest.

Shares, whether common or preferred, are freely transferable. The latter is a general principle set forth in Ecuador's corporate legislation by reason of the inherent nature of a stock corporation. Ownership of shares in a stock corporation is transferred by an assignment instrument signed by the transferor or by a person or a securities trading company representing the transferor. The assignment must be recorded on the corresponding share certificate or on an attached sheet. In the case of share certificates kept in custody by a centralised clearing and liquidation deposit, the assignment must take place pursuant to mechanisms established by those centralised deposits. An assignment of shares or a transfer of ownership takes effect against the company and versus third parties only as of the date of registration in the company's book of shares and shareholders. Such registration requires the signature of the company's legal representative upon delivery of a joint (or separate) communication from the assignor and the assignee.

If the shares are listed in a stock exchange or are immobilised in the centralised clearing and liquidation deposit, they must be registered in the book of shares and shareholders by the centralised deposit upon submission of an assignment form signed by the securities trading company acting as an agent. The centralised deposit must keep files and records of the transfers and must give notice thereof to the company on a quarterly basis.

Stock exchange aspects

If the shares of a stock corporation are not listed in a stock exchange, the only formality for their transfer is as described above, namely by means of an assignment document and registration of the assignment in the book of shares and shareholders. However, if the shares are listed in a stock exchange, several provisions of the Stock Market Law must be observed.

Therefore, shares of stock corporations listed in the stock exchange must be ruled by the conditions set forth in stock exchange legislation in order to be traded and transferred.

Assumption of control

Additionally, such individuals or juridical persons wishing to directly or indirectly control a company listed in the Stock Market Registry and subject to the Superintendency of Companies' or Superintendency of Banks' control and that individually or as a whole involve assuming a control of a company by means of one or several acquisitions must

report the planned transaction to the company, to the public and to each stock exchange at least seven business days prior to the date of the negotiation.

Limited liability companies

By reason of their different juridical nature (an association of persons and not of capitals), limited liability companies are governed by rules different to those relating to assignments of share interests. The capital of those companies is divided into share interests that, since they are not securities or moveables, cannot be freely assigned or transferred – unlike shares of stock corporations. Share interests are quotas (contributions) into the company's capital. Because share interests are not securities, they lack the characteristics inherent to shares: free circulation and valuation in the market, for instance.

Since limited liability companies are associations of persons (not of capitals), any possible circulation of such share interests could result in the company no longer having any meaning with regard to its partners – it would no longer be an *intuitu personae* association. Share interests, according to the definition in the Law on Companies, are the partners' contributions to the limited liability company's capital.

Transfer of share interests

Share interests of a partner in a limited liability company are transferable according to an action *inter vivos* for the benefit of another partner or partners in the company or of third parties if the unanimous consent of the capital stock is obtained pursuant to Article 113 of the Law on Companies. The first legal limitation is that unanimity is necessary for a transfer.

Share interests must be assigned through a public deed. The notary will include in the protocol or will attach to the deed a certificate from the company's representative evidencing that the condition referred to in the preceding paragraph has been met. The assignment will be registered in the company's corporate books. The second legal limitation is the formality of executing the assignment through a public deed.

III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT

Legal rules regarding mergers and acquisitions have remained unchanged in Ecuador for decades. Hostile takeover is not common and is not regulated, and there are no corporate strategies (by way of 'poison pills') to prevent or mitigate company takeover.

IV FOREIGN INVOLVEMENT IN M&A TRANSACTIONS

As already mentioned, substantial activity (in proportion to the market) by foreign investors in the area of mergers and acquisitions is taking place in Ecuador. Because of the political situation in Latin America and the financial crises in the United States and Europe, Chinese investment is very important in Ecuador. Although that activity is still in banks and the consumer sector, Chinese investments in Ecuador are quite active with respect to energy matters, particularly mines, oil, electric power and alternative energy

sources. Chinese investments (very significant in the past three years) have changed law firm practices, how fees are negotiated, and how clients are treated.

However, though Ecuadorean legislation is not discriminatory with regard to foreign investors, it should be noted that foreign shareholders in local companies must disclose corporate information to the Superintendency of Companies and to the Internal Revenue Service (the tax authority).

V SIGNIFICANT TRANSACTIONS, KEY TRENDS AND HOT INDUSTRIES

As already mentioned, the most active industries and sectors of the economy in matters of mergers and acquisitions in Ecuador are the agricultural industry and fisheries (particularly activities involving tilapia fish, shrimp, cocoa bean and bananas); consumer goods (particularly retailers of electrical appliances); the food sector (snacks and beverages); and the mandatory sale of non-banking assets of local banks in 2012. This series of sales where the US insurance industry was very much involved derived from a constitutional provision that compelled the banks to free themselves from non-banking assets and the new rules on competition.

With regard to the legal form of such acquisitions, the most common form is the purchase of shares in stock corporations or share interests in limited liability companies, or purchases of assets and liabilities.

VI FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS

Generally, transactions that take place in the Ecuadorean market are financed by the purchasers or by banks from abroad. It is not common for local banks to be involved in mergers and acquisitions.

VII EMPLOYMENT LAW

Regarding labour matters, it should be noted that our local legislation includes the definition of employer substitution that is regulated by the Labour Code and is applicable to the mergers and acquisitions regime.

By means of the aforementioned employer substitution, workers and employees of a company that is taken over are transferred to the company that takes over (in the case of mergers) or, in the case of purchases of assets or of assets and liabilities, workers and employees whose activities are related to transferred assets and liabilities are also transferred to the new employer. It is important to mention that such personnel are transferred to the new employer with all their previously acquired rights, seniority and conditions. In other words, for example, their vacation time or their retirement rights are accrued. Therefore, the new employer is obliged to respect the terms and conditions of the work contract inherited by way of the transaction. And since there is a new employer, the matter must be reported to the Ecuadorean Social Security System.

Ultimately, employment substitution means that any necessary due diligence process regarding companies or assets to be acquired should be especially rigorous.

VIII TAX LAW

Three particularly important tax issues are applicable in Ecuador when mergers and acquisitions are analysed: transfers of shares and share interests are tax-free; remittances of currency abroad are subject to taxes; and a total transfer of assets and liabilities is subject to a zero per cent VAT rate.

According to the Organic Internal Tax Regime Law, income deriving from occasional disposal of shares is exempted from income tax. Thus:

Article 9 – Exemptions: For income tax determination and settlement, only the following income is exempted: [...] (14) Income generated from the occasional disposal of real property, shares or share interests. To the effects of this law, occasional disposal shall be deemed to be that which does not correspond to the ordinary line of business or the usual activities of the taxpayer.

Sales of shares are not subject to VAT in Ecuador since there is a specific provision in that regard in the Organic Internal Tax Regime Law:

Article 54 – Transfers that are not subject to the tax: No VAT shall be incurred in the following cases: [...] (6) Assignment of shares, share interests, other securities.

Sales of shares are not subject to any other taxes in Ecuador.

The tax on currency remittances (ISD) is incurred by ‘the transfer or conveyance of currency abroad in cash or by drawing cheques, transfers, remittances, withdrawals or payments of any kind with or without participation of financial system institutions’. Upon applying the principle of territoriality of the law, it is understood that ISD is only applicable if the sender of the currency is a resident in Ecuador. The sender of such currency is legally responsible for paying that tax (ISD is not subject to withholding at source).

After November 2011 (when the Law on Environmental Development and Optimisation of State Income came into effect), two situations events were established that give rise to the obligation to pay ISD. One is when an Ecuadorean company makes payments with resources kept by it in foreign banks abroad or when payments are made through third parties.

Finally, it should be mentioned that, according to the Internal Tax Regime Law, a total sale of assets and liabilities gives rise to zero per cent VAT that must be reflected on a sales invoice. It is therefore advisable to specify in detail all the assets and liabilities involved in a transaction in order to prevent any tax contingencies. Aside from this tax advantage, a significant trend with respect to purchases of assets or of assets and liabilities has been observed in the past few years due to the fact that any processes involving corporate mergers are usually lengthy and bureaucratic. In addition, 12 per cent VAT applies when the transaction is merely limited to the assets or to certain assets and liabilities.

IX COMPETITION LAW

The Organic Law on Market Regulation and Control (the Law on Market Regulation) was enacted on 13 October 2011. On 23 April 2012, the President of Ecuador signed Executive Decree No. 1152 published in the Official Register of 7 May 2012, comprising

the regulations of that Law. This is the first time, from a domestic standpoint, that legislation on competition has ever existed in Ecuador and it is also the first time that prior control of mergers and acquisitions has been implemented in this country.

i Prior control

The Market Regulation Law includes several provisions relating to prior control of mergers and acquisitions. Their major characteristics are:

- a* economic concentration is defined as a change of control or takeover of one or several enterprises or economic operators;
- b* the prior authorisation from the Superintendency of Market Power Control must be requested when the thresholds set in the Law are exceeded. The Superintendency is the authority over this matter;
- c* actions on economic concentration are broad and provide examples of:
 - mergers;
 - transfers of all the assets of a businessman;
 - direct or indirect acquisition of shares or share interests or debt certificates giving rise to the right to control;
 - links through a common administration, as an example; and
 - any action or agreement transferring the assets of an economic operator or granting control or determinant influence on an economic operator's adoption of regular or extraordinary administrative decisions; and
- d* the regulations state that 'control' is to be understood as control over any contract, action or otherwise that, considering *de facto* and *de jure* circumstances, confer the possibility of exercising substantial or determinant influence over an enterprise or an economic operator. Control may be joint or exclusive.

ii The conditions

Two conditions must be met in order to request authorisation. First, the total turnover in Ecuador of all participants in the transaction (target and purchaser) should exceed – during the fiscal year prior to the operation – the amount of unified basic remunerations in force established by the Regulation Board. The Regulation Board, which according to the the Law on Market Regulation depends on the Superintendency of Market Power Control, has not yet determined the amount. Unified basic remunerations are a measure of value linked to the regime of salaries in Ecuador and are expressed in US dollars. Secondly, concentrations involving economic operators undertaking the same economic activity whereby, as a consequence of the concentration, a quota equal to or greater than 30 per cent of the relevant market of the goods or services in Ecuador or in a specific geographic market is acquired or increased.

iii Timing, terms and requirements – notice as of perfecting the agreement

Concentration operations that require a previous authorisation must be notified for prior examination within eight days of the date when the agreement is perfected (draft action or contract). The regulations to the Law on Market Regulation provide that 'perfection of agreement' is defined as follows:

- a* in the case of mergers: from the moment at least one of the participants at the shareholders' meeting has agreed to the merger;
- b* in the case of transfer of assets: from the moment the entities agree to the operation and determine the form, term and conditions thereof. For companies, this is the moment the transfer is approved by the shareholders' meeting;
- c* in the case of purchase of ownership of or rights over shares or share interests or debt instruments: from the time the participants consent to the operation giving rise to the concentration and they determine the form, term and conditions for its performance;
- d* in the event of a link established through a common administration: from the time the administrators have been designated by the shareholders' meeting; and
- e* any other agreement that factually or legally transfers the assets of an entity or that grants the entity a determinant influence or decision-making control: from the time the parties consent to the operation giving rise to the concentration and determine the form, term and conditions for its performance.

Officially or upon petition of the economic entities involved in a concentration operation, the Superintendency of Market Power Control may request notification even if the aforementioned conditions have not been met. The entities will be allowed 30 days to justify their failure to notify if the Superintendency considers that the concentrations exceeded the thresholds set in the Law on Market Regulation. Afterwards, a 60-day investigation will commence (extendable for an additional 60 days). Additionally, even if the aforementioned conditions have not been met, the parties can choose to voluntarily notify their concentrations to the Superintendency of Market Power Control; these concentrations will not require approval by the Superintendency.

iv Requirements for notification

Notice must be given by the operator who makes the acquisition or acquires control, except when several operators acquire joint control. In that case, notice must be given jointly through a common attorney-in-fact.

The regulations to the law provide for 11 information matters and five specific documentary requirements for each such notice. On 9 May 2013, the Superintendency of Market Power Control published the form that must be submitted to file a concentration notification; this form contains the 11 information matters and documentary requirements. Previously, notifications were not made in any form, but they had to include the 11 information matters and documentary requirements.

v Terms and charges

The authority is allowed 60 days to approve, deny or condition the transaction. That period is extendable for a further 60 days. It is not clear in the Law on Market Regulation whether the 60 additional days are working days or calendar days. The regulations have granted the Superintendency of Market Power Control the right to determine charges as established in the Law on Market Regulation and in the Organic Code on Planning and Public Finances, provided that an analysis of concentrations is the event that gives rise to the charge. On 9 May 2013, the Superintendency of Market Power Control published

regulations that include the parameters that will be used to determine the fee that will be charged in order to process each concentration notification. Those regulations establish that the processing fee will be the greater of:

- a* 0.25 per cent income tax (paid the previous fiscal year);
- b* 0.005 per cent of turnover (achieved the previous fiscal year);
- c* 0.01 per cent of the assets; or
- d* 0.05 per cent of the net assets.

However, the regulations do not specify to which of the parties involved those parameters will apply. We assume that these calculations will be made on the basis of the target's figures; however, given the lack of clarity, these calculations could be made on the basis of the acquiring party's figures, or even the aggregate figures of the target and acquiring party.

X OUTLOOK

It is quite likely that – at least in the medium term – the good conditions that have fostered the industry of mergers and acquisitions in Ecuador will continue. Stability in the region seems to be reasonable, the outlook of the local economy is promising, and prices of commodities and raw materials may continue at acceptable levels (particularly oil, which is Ecuador's main export product).

As a consequence of this, it is essential to establish how quick and how technical the system for prior control of mergers and acquisitions is likely to become. It is very important that the process to approve transactions is made more expeditious and that there is more certainty as regards the timing of the authority's decisions.

Appendix 1

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