

## Mergers & Acquisitions 2013 – Dominican Republic

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### 1. Has the level of M&A activity increased, slowed, or remained flat in 2012 as compared to 2011, and what are conditions like today? In general terms, what level of activity is foreseen for 2013?

M&A activity has remained steady in the Dominican Republic during recent years. One important identifiable trend is consolidation in industries where investment has been particularly significant during the past decade, perhaps to the point of building capacity in excess of local demand. Consolidation has also been driven by opportunities for regionalisation. In other instances, the potential for synergies has proven too attractive to be ignored.

More recently certain factors have been impacting the M&A landscape, most notably a revival of foreign investment in sectors where investment had diminished during the last decade, a surge of cross-border deals involving regional players acquiring companies in the Dominican Republic, and a sophistication of the financing of infrastructure projects.

In addition to the foregoing, some M&A activity is still related to restructuring of companies affected by the global financial crisis, especially in those sectors that are most exposed to foreign investment, such as tourism.

### 2. Which industries do you expect will see the most M&A activity in 2013?

We expect energy, telecommunications and infrastructure to be particularly active for the next twelve months.

In the case of energy, this will follow a plan put in place by the government for agreeing with the private sector on the nature and extent of investments required to overcome the country's current electricity shortfall, under the National Development Strategy Law. This "electric pact" means massive investment will be required and that returns could be high as a means of attracting investors, and players of all sorts (banks, investments funds, regional and international groups) are positioning themselves to take advantage of the opportunities. We expect most of the M&A activity to take the form of acquisition or restructuring undertakings around those companies with energy concessions, licenses and tax benefits.

As to telecommunications, some restrictions on investments, mostly on the regulatory side, such as those related to the expansion of available spectrum, are expected to be removed soon, opening the door for some much needed revamping of technology. In addition to M&A activity associated with the financing of these new investments, we anticipate that some key international players that have been long interested in the country but have been discouraged by the above-mentioned regulatory limitations will move to acquire positions in existing local players or even proceed with outright acquisitions. It is also likely that the sector will experience some consolidation through the merger of existing operations as the market gets more crowded.

Likewise, there will likely be increased activity in infrastructure projects as the government undertakes a comprehensive program of expanding and upgrading roads and transportation systems, partly with the purpose of accelerating the economy. In order to circumvent budget and indebtedness restrictions the different government agencies in charge of these projects are becoming

more creative, leveraging on new legal instruments to raise the necessary financing, such as *fideicomisos* (recently incorporated into the legal repertoire). The use of these innovative mechanisms opens the door for investment from all sorts of players. Some important international funds, construction companies and equipment manufacturers are already increasing their presence in the country in search of opportunities in these projects.

Finally, in addition to these three main sectors, some important activity is expected to occur in growing industries such as technology, as private equity funds search for niche investments, and some consolidation may take place in banking because of new regulation on risk assessment that will make it more difficult for smaller banks to compete. We also expect the continuation of trends identified in tourism and construction last year, especially in the latter, where M&A activity would reflect the consolidation trend aimed at capturing synergies, adjusting to a reduced projection of exports due to the economic crisis affecting most of the Dominican Republic's commercial partners, and in general coping with the cost of excess capacity built during the last decade upon a much greater expectation of economic growth.

### 3. What types of deals do you expect to see?

Most of the M&A activity referred to in the previous section will probably take the form of either outright acquisitions or mergers. However, four very important evolving trends are also likely to produce significant minority investments. One such trend has to do with equity positions taken by multilateral organisations and development banks, which have been gradually migrating from a pure lending pattern to investing in the capital of local companies. The second important trend relates to the gradual liberalisation by the government of restrictions imposed on pension funds to invest in new instruments. Pension funds continue to grow exponentially under a mandatory contribution structure but are limited in their ability to invest due to the relative lack of sophistication of our securities market and a very conservative stance of regulators, who decide the type and extent of investments by the funds. This may change because of both an increased offer of instruments in the securities market and the need for regulators to balance and diversify the overall portfolio of funds, now highly concentrated in local banks and government-issued debt. A recent very comprehensive modification of our Securities Regulation (which will be further deepened by an amendment to the Securities Law), paired with the advanced implementation process of Law 189 on Trusts and other instruments, is likely to contribute to the consolidation of this trend. The third evolving trend likely to contribute to a rise in minority investments is precisely the enactment of the accompanying regulations to Law 189 as well as other pieces of legislation oriented towards promoting the growth of new sectors like cinema, affordable housing, renewable energy and venture capital. All of these new statutes and bills have in common that they create incentives (especially tax breaks) for companies to invest in the different economic sectors the legislature attempts to promote. Finally, a rise in minority investments may result from increased activity in private equity.

4. Discuss the level of M&A activity you have seen over 2012 and expect to see in 2013 of: (i) pure domestic deals; (ii) deals in your jurisdiction involving a domestic target and foreign acquirer from Latin America, or a foreign acquirer from outside Latin America; and (iii) deals involving a domestic acquirer and foreign target in Latin America or a foreign target outside Latin America.

Mergers and acquisitions driven by the contraction of markets as a result of the economic crisis (including the downturn in export markets), as well as deals driven by the capture of identifiable synergies, as described above, are mostly domestic in nature. We include here the activities of some multinationals that have been long established in the Dominican Republic. The case of minority investments, particularly those associated to the new trends mentioned, is different. There have been important new foreign entrants, and we expect more, taking advantage of opportunities in cinema, renewable energy and affordable housing construction. Most of the private equity activity is also foreign in nature, as are, of course, the investments of multilaterals. The new pension fund investments are all domestic.

Most notably among Latin American acquirers recently have been companies from Colombia, Venezuela and Mexico. As companies, both large and small, in those countries look to expand their markets, they have been taking important positions in industries as diverse as construction, food, retail, tourism, transportation, banking, securities, insurance and energy.

By the same token, Dominican companies have been actively immersed in exploring opportunities for acquisitions in the region. They include large companies that may have exhausted their growth potential in the country or are in need of diversifying to limit their country-risk exposure, and also some smaller companies that have identified growth opportunities in regional markets where they have an interesting value proposition but whose local opportunities are limited by either saturation of the markets, contraction, or both. Although very few deals involving domestic acquirers and Latin American targets have been closed, the extent of current exploration of opportunities in very diverse industries is such that one should expect some significant deals to close within the next twelve months. Countries where potential domestic acquirers have been entertaining certain prospects, in some cases with advanced negotiations undertaken, include Colombia, Mexico, Venezuela, Peru, Guatemala, Costa Rica, Panama, Trinidad & Tobago, Jamaica and other Caribbean territories.

5. What is the level of private equity activity? Are domestic or international funds involved? What kinds of deals are they doing?

Private equity activity involving mainly international funds has been increasing steadily recently. Funds are in continuous search for opportunities in the country as they and their investors are seduced by the impressive returns. In most high-profile transactions that take place in the country, the presence of international funds as bidders is very common, and many transactions are triggered by funds that are actively pursuing and creating opportunities.

6. Is acquisition financing available for deals? For strategic buyers? For private equity buyers? From domestic or international sources? What amount of debt:equity leverage are you seeing in private equity transactions?

Acquisition financing is readily available for all kinds of buyers (strategic, private equity) as the Dominican legal system provides for an efficient, loosely-regulated framework for lending and security. Banks have remained fairly liquid for the most part of the last decade, and the Central Bank has kept a flexible and open environment with historically-low interest rates, except for certain short periods where it has reacted to a heating economy and signs of inflation fueled by government spending. Other sources, such as private equity, have also remained very liquid and eager to finance acquisitions in all sorts of industries. As regulators start paving the way for pension funds to invest in private equity the availability of financing for acquisitions starts to grow exponentially.

Although generally private equity deals are structured following a 50-50 debt-equity ratio, some higher-leveraged transactions (up to 65 to 70 per cent debt) are common in mature industries such as retail.

7. How open is your country to investments and acquisitions by foreign buyers? Is there a level playing field when foreign and domestic bidders compete to buy the same domestic target company?

The Dominican Republic is absolutely open to investments and acquisitions by foreign buyers. The legal system makes no discrimination in terms of either percentage of ownership, approvals, exchange or otherwise. Restrictions or limitations that would apply to foreign entrants would apply to Dominican companies and investors as well. As a result, there is in fact a level playing field where foreign and domestic bidders compete for the same domestic company. The most recent significant bids have indeed been awarded to foreign companies.

8. Do you expect more M&A activity involving financially troubled companies?

Many important companies remain in financial distress due to the global economic crisis and the prospects for recovery in the short term are not great. These are companies that leveraged on their success and the incredible growth pattern of the Dominican economy and issued or contracted debt to finance their expansion projects (new lines, new plants, new products, or an acquisition). Even though the growth of the economy has been spectacular by any international standard nowadays, it has still remained short of expectations for Dominican entrepreneurs, and the fact that most of the growth has been associated to government spending in infrastructure means that many industries, in fact the majority of them, have had only marginal growth or no growth at all. Hence sound, well-managed companies have been left with above-optimal levels of indebtedness. With few exceptions, these companies in financial distress are very attractive targets for acquisitions because they have good, well-positioned brands, fantastic market share, robust management, good business plans and good prospects for going regional.

9. Does your country's bankruptcy law permit the reorganisation of the debtor as a going concern, and the acquisition of the entity out of bankruptcy?

A much awaited and debated bill on business restructuring has been in the agenda of Congress for a long time. It would provide for the reorganisation of a distressed debtor as a going concern, and would allow for the acquisition of the troubled company out of bankruptcy. There is no clear date for the passing of the law, as legislators, along with business and civil associations, are still in deep discussions of certain fundamental aspects of the bill, for instance, whether the reorganisation should be conducted by a court of law or by a non-judiciary body.

Despite the lack of a restructuring law in the Dominican Republic, since some local companies issue securities under foreign jurisdictions (most notably the US) there are indeed instances of restructuring and acquisitions that take place in the process of reorganisation. At least one very large company changed hands during the last five years through the acquisition of publicly-traded debt by the ultimate acquirers followed by an agreement to capitalise such debt.

10. More generally has there been any increase in hostile takeovers and shareholder activism? What defences and responses are target companies using?

There has been no case of hostile takeover in recent years and, apart from some opportunistic behavior of shareholders in certain high-profile cases within the last three years, shareholder activism remains low.

11. Have directors, management and controlling shareholders changed how they conduct themselves in M&A deals? What kind of fiduciary duties do directors, management and controlling shareholders have under the laws of your jurisdiction? From your experience, are directors, management and controlling shareholders more diligent today in their review of M&A transactions and other matters?

The relatively recent Law on Business Associations has profoundly changed management behaviour in the Dominican Republic in all kinds of matters, not only M&A. Although the Dominican legal system already contemplated the fundamental principles of fiduciary duties, the fact that the new Law has

made such an explicit and detailed reference of those fiduciary responsibilities (the standard duty of care and duty of loyalty) has produced a notable cultural shift. The change in the dynamics of boards has also been influenced by the fact that the Law provides for directors' compensation and therefore boards have become more professional. There is also a related increase in the presence of independent directors (in most regulated industries a certain component of independent directors is mandatory). The new Law is also very explicit about the legal remedies available to shareholders in the case of a breach by directors of their fiduciary responsibilities, and this has made shareholders' claims and activism more likely, further contributing to the shift in management behavior. As a consequence of all of this, M&A is now the subject of a more careful, transparent and professional review by boards, with much more involvement from shareholders (at the call and request of directors). Under current law most fiduciary duties applicable to directors are deemed to apply as well to top management, controlling shareholders and professional administrators (such as fund managers).

**12. Should directors, management and controlling shareholders be more concerned today about negative publicity, shareholder criticism, regulatory pressure and liability from potential litigation?**

Because of the expanded legal criteria for the evaluation of management behaviour and the increased consciousness of the market on issues of fiduciary responsibility, directors, top management and controlling shareholders do have to be more concerned about potential negative publicity, regulatory pressure and both civil and criminal liability. This has been reflected, for instance, in a considerable increase in companies' expenditures in directors' insurance.

**13. Are there major differences in how domestic and cross-border deals are being conducted? For instance, does the type of purchase agreement used in your jurisdiction differ significantly from the international style of agreement? If so, which type is being used more often?**

The typical form of purchase agreement used internationally has become common use in the Dominican Republic even for purely domestic deals. Some adaptations are sometimes made to adjust to local law references. For instance, "representations" are usually called "declarations"; "affirmative covenants" are referred to as "*obligaciones de hacer*"; and "negative covenants" are referred to as "*obligaciones de no hacer*"; likewise, "conditions precedent" are renamed "*condiciones de efectividad*". The reason in all cases is taking advantage of specific references of the civil code as well as of certain special statutes, thus facilitating interpretation and enforcement by judges and arbitrators.

**14. For international buyers and investors looking at deals in your jurisdiction, what are the three most important pieces of advice you have and what are the pitfalls that should be avoided?**

Firstly, in most M&A cases we advise in favour of structuring the deal as an asset transaction (as opposed to a merge or a share transfer). This is for three reasons: a) our tax system produces a fairly neutral framework where the overall income taxation of the deal would not differ significantly depending on the structure chosen, thus removing income taxation as a determinant factor in M&A planning (in contrast with the situation in many other jurisdictions where the potential income tax, especially on capital gain, constitutes the main driver of structure); b) the implications for the transfer of intangible assets (intellectual property, licenses, permits) are also basically the same regardless of the chosen structure; and c) the system provides for a very strong shelter against hidden liabilities when the deal is structured as an asset transfer, except for tax and labour liabilities, but these tend to be easily quantifiable and thus are compensated through the standard indemnities contained in the purchase agreement. Secondly, we strongly advise in favour of arbitration as the dispute resolution mechanism for conflicts related to interpretation of the purchase agreement or related to a breach of the parties' obligations. When a local asset has been granted as collateral (for instance, as security for liability indemnities or deferred payment), arbitration is not available and the parties must submit the case to ordinary courts. Dominican arbitration law is very modern and follows best international practices, and chambers of commerce have extensive experience

(in particular the Santo Domingo chamber) administering arbitration forums. In addition, the Dominican Republic is a signatory of the New York Convention on Arbitral Awards, and it is customary for the parties to submit to international arbitration (usually under ICC or AAA rules) when one of them is a foreign entity.

The most important pitfall to be avoided is related to the lengthy processes required for the completion of asset transfers. Many deals are either aborted or seriously affected by the frustration of the parties for the extent and unpredicted delays of the timetable. Most asset types are subject to some kind of previous authorisation or clearance by the tax authorities, or the final tax cost of a transfer may be uncertain until a clearance process is completed. When the assets include real estate property, there is the added time of the registration protocol, which is highly cumbersome, and may include judicial intervention in cases of fractionated ownership (typical in non-urban settings). The approval process for the transfer of licenses and permits is also very lengthy. This timing problem affects all options of acquisition structure, but the problem is exacerbated by the fact that asset transfers are the advisable choice, for the reasons stated above. Our advice to avoid this pitfall is for the parties to contemplate from the onset of their negotiations some form of interim possession and control of the assets, through the appropriate set of agreements. The parties may feel that this brings an unwanted complication to the deal, but the added benefit of deriving value of the target assets and being able to exploit the identified synergies usually more than compensate for the extra planning required for interim control. Also, in most cases the transfer process is actually optimised, in terms of time, by following the lengthy approval process (especially when some form of reorganisation treatment is possible) instead of shortcutting it, so it pays to phase the deal in stages by incorporating interim control.

**15. Have there been changes in the process for how M&A transactions are conducted in your jurisdiction?**

Tax regulations have been gradually moving to reach the income tax neutrality referred to above. M&A planning and negotiations used to be largely driven by important differences in total tax impact for a transaction depending on the structure selected, hence producing some sort of trade-off between the relative impact of other variables, such as control of intangibles and the risk of contingent liabilities, and that of tax cost. The gradual shift to neutrality has been mainly achieved by establishing controls over the use of offshore layers of ownership and reorganisation processes, and the result is that parties must now

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give a greater share of attention to other variables. The parties still dedicate a disproportionate share of time to planning and negotiating tax aspects of the deal, but the expectation is that this will cease to be so as the market adjusts to the new regulations. The most advantageous tax planning under the new system is the one that takes place during normal operations, in anticipation perhaps of a future transaction, but not upon closing of the transaction per se.

The other significant change in the legal framework affecting M&A relates to competition regulation. Dominican competition law does not require ex ante review of acquisitions or mergers that may result in a dominant position in the relevant market. The law does not prohibit the emergence of dominant positions but concentrates on the abuse of such dominant position and other restricted practices. Nevertheless, the regulatory oversight that results when a company is regarded to be in a dominant position is such that M&A nowadays need to incorporate its impact in the representations and warranties provided for in the purchase agreement, as well as in the indemnities. In an acquisition, the purchaser needs to factor in the added cost of regulation, and in a merger both parties need to agree, usually by means of a shareholders agreement, certain governance provisions aimed at ensuring that operations will be managed in compliance of competition law. All of this is enlarged by the fact that regulators are entitled to declare that the company resulting from the transaction is in a dominant position (before any case of abuse), thus formally placing the company in the oversight spotlight.

16. Have there been any significant developments in the regulatory area – your country's security exchange commission, antitrust regulators, etc.?

The Dominican legislative landscape has been under profound transformation recently and several of the new statutes and regulations (whether already enacted or in process of being enacted) are very likely to impact M&A activity. Foremost among new initiatives is the new regulatory framework on competition. Although the Competition Law is already six years old, both the appointment of competition officers and the issuance of complementary regulation are still under way but soon to be completed (competition commissioners have been in office for over three years, but the executive director, who will bear the main responsibilities of leading antitrust investigation, is yet to be appointed). Likewise, securities regulation has been significantly transformed through the enactment of a new Securities Regulation, which is having a profound impact in the way investment products are designed as well as in the behaviour of market participants and the way transactions are conducted. The extent of the impact of these regulatory changes is yet to be assessed, as the market is still under the regulatory adjustment period provided and complementary regulation may need to be issued. The Superintendency of Securities has also announced that it is working on a draft amendment to the Securities Law to be proposed to the Executive for subsequent submission to Congress.

17. Describe recent and forthcoming regulatory developments that affect M&A, whether involving the securities and markets regulator, competition agency or other regulatory agencies that review deals?

Please see the answer to question 16.