Nicaragua

Negotiated M&A Guide 2022

Corporate and M&A Law Committee

Contacts

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1. INTRODUCTION

1.1 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, and 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.[1]

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. The improvements may come from marketing gains, strategic benefits or market power.

A second way of acquiring another company is to buy its shares with voting rights, giving in exchange cash, shares and/or 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, which can be achieved through a direct offer. The offer is communicated to shareholders of the target company by public announcements.[2]

A company may also acquire another company by buying the whole assets of the target company. An asset acquisition involves the transfer of title. However, the procedures used for the transfer of assets can be costly.[3]

1.2 M&A in the Central American context

Central America is a region which had an estimated population of around 181.7 million in 2021.[4] In 2020, the United Nations Economic Commission for Latin America (CEPAL) predicted an annual increase in gross domestic product of 3.8 per cent in 2021 for Central America.[5]

In 2006, the Dominican Republic, Costa Rica, Honduras, Guatemala, El Salvador and Nicaragua signed and ratified a free trade agreement (FTA) with the United States (DR–CAFTA). Additionally, in 2011, the Central American countries signed an FTA 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 an acquisition in Central America was the acquisition of BAC Group by General Electric Consumer Finance. BAC 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$7.5bn in assets, a US$5.2bn credit portfolio and US$4.7bn in deposits.

In 2005, GE Consumer Finance acquired 49.99 per cent of the shares of BAC International

[1] Stephen A. Ross; Randolph W. Westerfield and Jeffrey F. Jaffe, Corporate Finance, 12th edition (McGraw Hill, 2018), 899.
[2] *Ibid,* 900
[3] *Ibid.*
[4] Central America Population 2021 (World Population Review), see http://worldpopulationreview.com/continents/central-america-population, accessed 27 September 2022.
[5] *Latin America and the Caribbean: Growth Projections for 2020 and 2021* (CEPAL, December 2020), see www.cepal.org/sites/default/files/pr/files/table_press_gdp_preliminaryoverview2020-eng.pdf.

Group and in 2009 it acquired another 25 per cent of the shares of BAC Group, reaching 75 per cent ownership. The transaction was valued at around US$1.4bn for the purchase of 75 per cent of the shares.

Another example of an acquisition 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. It was a regional bank with offices in Guatemala, Honduras, El Salvador, Costa Rica, Panama and Nicaragua, and 75 branches. GFU also consisted of 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 to be approximately US$1.5bn.

1.3 Latest trends

The latest trends of M&A in Central America have seen companies in different sectors becoming targets. These sectors include energy, banking and insurance, cement, paints, mining, transportation, construction, fintech, and others.

Since the beginning of the Covid-19 pandemic in 2020, M&A transactions have become slower to process. This is due to the number of public officers being limited by confinement orders, resulting in a delay in obtaining apostilled documents from abroad. Customers have also demonstrated sensitivity to the cost issues of these types of transactions due to the risks associated with the pandemic.

However, Covid-19 also brought expansion in fintech-related issues, and these companies have grown considerably since 2020.

1.4 Important transactions

The banking sector is one of the most competitive sectors, and therefore sees more transactional activity in Central America. In addition to the mergers and acquisitions mentioned above, in 2012, HBSC Holdings sold its assets in Costa Rica, El Salvador and Honduras to Colombia's Banco Davivienda for US$801m in cash, representing approximately 4.6 per cent of the total assets of the South American entity. In December 2010, Grupo Aval – which is the largest financial group of Colombia – purchased 100 per cent of the shares of the financial group of Banco de América Central-Credomatic, which has banking branches and credit card offices across the entire region.

In 2009, Walmart Mexico acquired 100 per cent of the shares of Walmart Central America, owned by Walmart Stores in the US (51 per cent) and minority investors in the region (including CSU from Costa Rica and the Guatemalan company La Fragua). The transaction saw a cash payment of US$110m and the sale of shares.

In 2013, Cementos ARGOS from Colombia, expanded its presence in Central America with the purchase of 53 per cent of Lafarge from Honduras, for US$305.4m. The Peruvian entrepreneur group Ferrycorp, whose principal activity is the sale of capital goods and related services, also increased its presence in Central America through the acquisition of 100 per cent of the Nicaraguan enterprise Mercalsa's stock for $5.2m. In the same year, Bancolombia, one of the major holdings in South America, agreed through its subsidiary Bancolombia Panama the acquisition of 40 per cent of the financial group Agromercantil for US$216m. In the paint industry, World Investment Group 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 of US$120m.

Also in 2013, the main gold mining company in Colombia, Mineros, bought 90 per cent of the shares of the Nicaraguan mining Company HEMCO, which operates a mine in Bonanza, in the North Atlantic Autonomous Region (RAAN). HEMCO's acquisition coincided perfectly with a good year for the export of gold, as it was the export from Nicaragua according to the Center for Exports (CETREX), with a value of US$109.5m.

There were also significant acquisitive moves in the oil, energy and telecommunication sectors. Among them was the purchase of 100 per cent of the Guatemalan company Central Electricity Distribution by Public Enterprises Medellin ESP; this transaction was carried out for US$605m.

In the oil sector, Petróleos DELTA, a subsidiary of the General Investment Company of Panama, acquired, 100 per cent of the shares of Shell Costa Rica in December 2010, in a transaction whose amount was not revealed. In the pharmaceutical sector, the Central Pharmaceutical Corporation SA (CEFA) sold 50 per cent of its shares to the Chilean pharmaceutical group SOCOFAR. 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 internationalisation 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 for cash and its operations in Jamaica. The amount of the transaction was not disclosed.

1.5 Applicable corporate and other legislation in Nicaragua

Nicaraguan laws briefly regulate mergers of companies. Mergers are primarily regulated in the Commerce Code and in the Law on Competition Promotion. The Commerce Code of Nicaragua establishes the following procedure for a merger:[6]

> 'In order that the merger can be carried out, 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 looking to enter into the merger may oppose 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 whose bylaws should be subject to the approval of the Executive Branch, require such approval from the Executive Branch to merge.'

Law No. 601 on Competition Promotion is amended by Laws No. 668, No. 773 and No. 868 amending 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 independent economic agents that sign an agreement of

[6] Articles 263–268.

merger, acquisition, consolidation, integration or combination of their business in whole or in part, thus ceasing being independent.

Types of concentrations include:[7]

a) *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.
b) *Horizontal:* When the economic agents are positioned on the same level of production or marketing.
c) *Cluster concentrations:* When the economic agents that are intended to concentrate participate in various unrelated markets, in order to expand their scope of activities.

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

2. STRUCTURE OF THE TRANSACTION

There are a virtually 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.

The goal is not to create the most complicated transaction, but to create a structure which fairly reflects the goals and objectives of the buyer and seller. Naturally, not all 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 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.

2.1 Structuring the deal: stock versus asset transactions

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

Each form has its respective advantages and disadvantages, depending on the circumstances surrounding each transaction. In Nicaragua, as in the US, the buyer and seller should consider the following factors: tax issues, non-transferable rights or assets, the corporate name and goodwill of the company, the corporation's liabilities, unemployment or workers' compensation insurance ratings, complexity of the transaction, bargaining agreement, accounting methods, licences and permits, etc.

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

2.2 One-step versus multi-step transactions

Another key issue regarding the structure of the deal is whether the entire transaction will be

[7] *Concentrations Application Guide*, (Procompetencia, 2009), 10.

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.[8]

The seller may even have reservations about the buyer or want to see certain contingencies met before it commits to selling 100 per cent 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.

2.3 Method of payment

The way in which the seller will be paid is 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 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 (licences, franchises, etc), secured and unsecured promissory notes, common and preferred securities of the purchaser or their affiliates (often with the promise that these securities will one day be publicly-traded), earn-outs, consulting and employment agreements, royalty and licence agreements or even the exchange of another business. All these tools should be considered when structuring the elements of the purchase price.

3. PRE-AGREEMENT

3.1 Letter of intent

Letters of intent (LOI) resemble written contracts but are 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 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.

[8] Professor Andrew Shearman, Mergers & Acquisitions Course, Georgetown University.

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

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

The LOI is an indicator of the quality of the first draft of the definitive document of the transaction, so it is a very important part of the transaction.

3.2 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, labour, 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.

3.3 Lock-up (or voting) agreements with major shareholders

According to Nicaraguan law, a merger must be preceded by an agreement of the general meeting of shareholders, as previously stated.

Article 262 of the Code of Commerce establishes that 'unless provided in the bylaws, approval of a merger requires three-quarters of the social capital and the votes of the present members who represent half of the capital'.

4. ACQUISITION AGREEMENT

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: legal, business, taxes, accounting, etc. However, there are sections that we can identify as common in most agreements, which are:

a) preamble:
b) parties and the recitals;
c) purchase and sale;
d) closing;
e) seller's representations and warranties;
f) purchaser's representation;
g) covenants;
h) conditions precedent;
i) termination;
j) indemnification; and
k) general provisions.

4.2 Holdback and escrow

Options for escrow and holdback are available in Nicaragua. Nicaraguan banks are authorised to perform these operations; arrangements for both agreements can be negotiated by the parties.

4.3 Representations and warranties

As with acquisition agreements in the US, the seller and the buyer will make representations and warranties to the other. Representations and warranties serve as a mechanism of disclosure for the seller and also help identify and allocate the risks between seller and buyer. It is very important to tailor the representations and warranties to the particular business and transaction. The most common representations and warranties include:

a) corporate organisation;
b) subsidiaries and other ownership interests;
c) authorisation;
d) capitalisation of target and subsidiaries;
e) financial statements and projections;
f) absence of undisclosed liabilities;
g) most recent inventory;
h) taxes;
i) accounts receivable;
j) title to assets;
k) title to stock;
l) compliance with laws;
m) litigation and claims;
n) intellectual property;
o) environmental matters;
p) major contracts; and
q) employee benefits.

The survival periods of representations and warranties are usually between 12 and 24 months, depending on the results of the due diligence process regarding the target's business.

4.4 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 its 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-party orders and consents; and
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 if:

a) as result of the merger or acquisition, the market share obtained is 25 per cent or more of the relevant market; or
b) the firms involved have a gross combined income higher than approximately US$78m.

The request for authorisation must be made before the merger or acquisition. Procompetencia has the power to reverse a merger or acquisition executed without due authorisation, which could be partial or total.

In addition, 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 times the minimum wages amount, which represents a penalty ranging from US$15,400 to US$92,400.

Typical post-closing covenants include:

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; and
e) covenants regarding purchase price allocations.

4.5 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 closing, and the pre-closing covenants have been performed or fulfilled prior to closing. Other typical conditions to closing include:

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

4.6 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 an indemnity ‘basket’ or a ‘deductible’ of seller’s indemnification obligation in order to eliminate small indemnification claims.

4.7 Dispute resolution

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

Mediation and arbitration are regulated in Law 540, the 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.