GLOBAL LEGAL INSIGHTS

MERGERS & ACQUISITIONS – 2ND EDITION

CHAPTER TEMPLATE

SUMMARY INFORMATION
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Overview

1. Mergers:

A merger is a transaction whereby a company is joined to another company.

1.1 Types of mergers:

There are two types of mergers, since a company may absorb another company, or the merged companies may form a new company. In addition, there are the so-called atypical mergers.

1.1.1 One company absorbs another company:

The shareholders of the companies that are to be merged agree that one of the companies shall merge into the other one, so that the latter absorbs the former. In this case, the absorbing company survives the merger, while the other company ceases to exist; no new legal entity is created. This is provided for in Article 346 of the Commercial Code, which refers to the company that subsists.

1.1.2 The merged companies form a new company:

The shareholders of the companies that are to be merged agree that both companies shall merge into a new company, which is created as a result of the

merger. In this case, the merged companies cease to exist and the company resulting from the merger is a new legal entity. This is provided for in Article 346 of the Commercial Code, which refers to the company resulting from the merger.

1.1.3 Atypical mergers:

In some cases, there is no actual merger, but a contractual arrangement the purpose of which is to create a situation that is similar to the one obtained by means of a merger. For instance, two companies are managed jointly, as a result of a shareholders' agreement; or one company sells all its assets and businesses to another company, the former is dissolved and the latter carries on its commercial activity. In these cases, the rules regarding mergers do not apply. We shall not refer here to these so-called atypical mergers, which are not really mergers.

1.2 Characteristics:

In a merger, the assets, rights and obligations of the merged company are transferred to the company ensuing from the merger, which may be one of the merged companies (see 1.1.1 above) or a new company (see 1.1.2 above). In both cases, the transfer is automatic and covers all assets, rights and obligations (Article 346 of the Commercial Code).

If the company ensuing from the merger is one of the merged companies, the other company is dissolved. If the company ensuing from the merger is a new company, the merged companies are dissolved.

Even though the transfer is automatic, in the event that there is real estate or there are other assets subject to registration, it is advisable to file the registered property in the name of the company that ensues from the merger, if the assets are in the name of a company that is dissolved as a consequence of the merger.

The shares of the entity ensuing from the merger are distributed between the shareholders of the merged entities.

The merger does not give the shareholders who do not agree the right to withdraw from the company. They may, of course, sell their shares or dispose of them in any other way.

1.3 Requirements:

The shareholders of each of the companies that are to be merged have to agree to the merger, in the corresponding shareholders meeting (Article 343 of the Commercial Code).

The quorum, voting rights, etc., will depend on the respective bylaws. If the bylaws do not provide anything, shareholders owning ¾ of the equity have to be present and shareholders owning ½ of the equity have to agree to the merger (Article 280 of the Commercial Code).

In many cases, in addition to the minutes of the shareholders meetings, the companies that are to be merged enter into a merger agreement. Such documents must be precise as to the kind of merger, the way the shares are to be distributed, etc.

The minutes of the shareholders meetings and the merger agreement, if any, must be filed at the commercial registry, along with the balance sheet of the merged companies (Article 344 of the Commercial Code).

The actual merger takes place three months after such registration. During these three months, the merged companies' creditors may object to the merger. If there is no objection, or if the creditors who object are paid what is owed to them, the merger goes through (Article 345 of the Commercial Code).

2. Acquisitions:

2.1. The agreement:

In order to assign shares in a Venezuelan company, the assignor and the assignee must agree to the terms of the assignment. The assignment of the shares is perfected between the parties, and therefore produces effects between the parties, from the moment both parties have agreed to such assignment.

The agreement may be an informal verbal deal or a written contract, and –if the latter– may be subject to formalities such as notarization and/or registration.

Indeed, in certain cases, the parties may wish to have evidence of the exact date the agreement was executed (*fecha cierta*). In this case, the parties may sign a written agreement before a Notary Public, who will certify the identity of the persons subscribing the agreement as well as the date. If, for instance, as part of the negotiations the shares are going to be pledged, it is necessary that the document where the pledge is granted should have a certified exact date.

If the company is publicly traded, and the transfer regards a "significant majority" (10%) of its shares, then the transaction is subject to a strict procedure under supervision by the National Superintendence on Securities (a topic not covered in this article).

2.2 Shareholders registry:

With regard to the effects of the assignment before third parties, however, the Venezuelan Commercial Code provides the following:

> *Article 296.- Ownership of nominative shares is proven with the inscription in the books of the company, and their transfer is made by a declaration in the same books, signed by the assignor and the assignee or by their proxies*

Therefore, the Commercial Code establishes that the inscription of the shareholders registry proves the ownership of company shares. And that in order to prove that a transfer of shares has occurred, a declaration of such transfer must be inserted in the book of shareholders, and it must be signed by the assignor and the assignee. The Commercial Code further provides that such shareholders registry must contain the name and domicile of each shareholder, the number of shares the shareholder owns, the amounts contributed initially and by any subsequent capital increase, as well as any transfer of shares (Article 260 of the Commercial Code). The shareholders registry is kept by the company, and it must be available to the shareholders (Article 261 of the Commercial Code).

Consequently, for the assignment of shares to produce effects before third parties, it must be formally recorded in the shareholders registry.

2.3 Commercial Registry:

Venezuelan companies are autonomous legal entities, with "juridical personality" (*personalidad juridica*) (Article 201 of the Commercial Code). Their shareholders (who initially must be at least two) must agree to the bylaws, and register the act of incorporation and bylaws before the Commercial Registry, and publish them in a local periodical publication (normally a specialized journal) (Article 215 of the Commercial Code).

Every year, the company must hold an ordinary shareholders meeting for the approval of the company's financial statements, and other administrative matters. Occasionally, the company may hold extraordinary shareholders meetings to take certain decisions. The minutes (*actas*) of the ordinary shareholders meeting, as well as the minutes of some other shareholders meetings which contain certain resolutions taken by the company after its incorporation, must also be registered and published, according to the Commercial Code. For instance changes to the bylaws, mergers, the dissolution of the company, the designation of the administrators, etc. (Article 217 of the Commercial Code, among others).

Therefore, the Commercial Registry's file on each company contains a historical record of the shareholders present at shareholders meetings; but only of those meetings which treat subjects that the law requires to be registered. And since there is no legal requirement to register the transfer of the shares, the Commercial Registry's file may show that a company has certain shareholders when the ordinary shareholders meeting was held, and has other shareholders at the next registered shareholders meeting minutes; but there does not have to be evidence at the Commercial Registry of the transfers of shares which may have occurred in between, or after the last registered minutes.

In order to have evidence of the current owners of the shares of a company, the shareholders registry must be consulted.

The text of article 296 of the Commercial Code quoted above is very clear; however, in March 2009, the Supreme Tribunal of Justice, in its Political-Administrative Chamber, issued a very controversial decision. In what has come to be known as the Agroflora decision (the parties were the tax authority and a Company called Agropecuaria Flora C.A., Agroflora), the judge sentenced that in order for the transfer of shares of a company to produce effects before third parties, such transfer had to be registered before the Commercial Registry and published in a local newspaper. One of the oddities of this judicial decision is that it does not mention article 296 at all, but refers to other articles of the Commercial Code which do require certain resolutions to be registered and published. This decision has been widely criticized; and at least two subsequent decisions of the Supreme Tribunal of Justice have ignored it, sentencing in accordance with article 296 of the Commercial Code. However, a few first instance courts have followed the Agroflora decision.

As a consequence of the above, and in order to avoid problems regarding the effects before third parties (for instance the tax authority), for reasons of practicality many individuals and corporations now participate the sale of shares to the Commercial Registry, or hold an extraordinary shareholders meeting where the shares are transferred. This may be useful, but is unnecessary under the law.

2.4 Registration of foreign Investment:

Even though Venezuela is no longer a member of the Cartagena Agreement, the rules regarding foreign investments which were approved by its members, including Venezuela, are still being applied, since they followed the internal legislative procedure, having been approved by the Venezuelan Congress and published in the Official Gazette. According to such legislation, there is an obligation to register foreign investments within 60 days before the Superintendence of Foreign Exchange (SIEX); but the absence of registration is not penalized.

In an acquisition of shares, if made in foreign currency, the amount used to acquire the shares must be exchanged, through the banking system, at the Central Bank, at the official exchange rate. Then a lengthy procedure must be followed in order to register the investment. The registration before SIEX gives the investor the right to request the repatriation of dividends, and eventually of capital, at the official exchange rate, by following procedures established by the foreign exchange authority (CADIVI) under very strict rules. The foreign currency requested may or may not be granted, depending on governmental priorities and availability, according to such rules.

If the shares being acquired are already a registered investment in SIEX, then their assignment must be notified to SIEX.

2.5 Notice to the tax authorities:

If the acquisition of shares implies a “change” of shareholders, it must be notified to the tax authorities (Seniat), within 30 working days, in accordance with the regulations of the tax information registry.

2.6 Certificate of social security solvency:

The Social Security System Law orders Commercial Registrars to request a certificate of social security solvency, in order to register any “sale, assignment, lease, donation or transfer of dominium of enterprises or establishments”. The wording of this provision (which does not use the word “control”, but the more obscure “dominium”) has been taken to mean that in order for the Commercial Registrars to register a shareholders meeting minute which refers to a transfer of shares, the company must present a certificate of solvency issued by the Venezuelan Institute of Social Security.

2.7 Right of preference or right of first refusal:

It is in the nature of company shares to be transferable. Provisions which seek to prohibit the transfer of shares are not legal in Venezuela, even if established in the bylaws and agreed to by all the shareholders.

However, some limits may be placed on share transferability. Among the most common is the establishment of a right of preference in order for the current shareholders to acquire any shares which other shareholders wish to offer. This right of preference must be established in the bylaws; if absent, the general rule of transferability applies. The shareholders may agree to specific procedures to implement the right of preference or simply state that there is a right of preference; but the end result must be that the shares are transferable.

Other bylaw provisions may try to limit the free transfer of shares; for instance, giving the other shareholders the right to approve of the assignee. These provisions may

be valid inasmuch as the essential quality of transferability is not denied to the assignor.

Key Developments, Significant Deals And The Year Ahead

1. Special laws:

Some companies are subject to special laws; for instance, banks are subject to the Law on Banking Institutions, and insurance companies are subject to the Law on the Insurance Activity.

In some cases, for a change of control to take place, these laws require an authorization from the corresponding regulator. Here are two examples: for a relevant percentage of the shares of a bank to be sold, the approval of the Superintendent of Banking Institutions is needed; and, for a relevant percentage of the shares of an insurance company to be sold, the approval of the Superintendent of the Insurance Activity is needed. And there is even one case in which the regulator did not approve a sale because the government wished to buy the relevant company. Indeed, when the Spanish Banco Santander decided to sell its Venezuelan subsidiary, Banco de Venezuela, to a Venezuelan bank, Banco Occidental de Descuento, the Superintendent of Banking Institutions denied his approval, so that Banco de Venezuela would have to sold to the Venezuelan government, which apparently acquired it in the same terms and conditions that Banco Santander was offering to Banco Occidental de Descuento.

In some cases, the special laws that regulate certain companies only allow mergers when these companies are of the same kind; for instance, a bank can only be merged with a bank, and an insurance company can only be merged with an insurance company. In some cases, these laws require an authorization from the corresponding regulator, prior to the merger; for instance, for two banks to merge, the approval of the Superintendent of Banking Institutions is needed; and, for two insurance companies to merge, the approval of the Superintendent of the Insurance Activity is needed. In some cases, these laws demand that the changes in the bylaws of the company that results from a merger or survives the merger are approved by the regulator; for instance, the bylaws of the resulting or surviving bank require the approval of the Superintendent of Banking Institutions, and the bylaws of the resulting or surviving insurance company require the approval of the Superintendent of the Insurance Activity.

All these approvals take time.

Mergers and acquisitions normally result in a change of the members of the board of the companies involved. Even when there is no merger or acquisition, the Superintendence of the Insurance Activity, in particular, has to expressly allow the appointment of each director in every insurance company, and it takes many months to give its green light to any such appointment. The registration in the Commercial Registry also takes time. Both the Superintendence of the Insurance Activity and the commercial registries require many unnecessary documents, such as Venezuelan business visa for the foreign directors, even if they reside abroad.

Similar considerations may be made with respect to other special laws, for instance, the Telecommunications Organic Law.

2. Expropriations and confiscations:

In Venezuela, several hundred companies have changed hands in the last years, without a proper merger or acquisition. In most of these cases, an expropriation takes place, without any procedure and without any compensation. These so-called expropriations are really confiscations. The government has not applied the constitutional and legal requirements, but challenging these “expropriations” has very limited chances of success, because it controls the judiciary. Should the political situation change, there are very clear grounds for annulling these “expropriations”:

In the first place, an expropriation can only take place, within the context of a due legal procedure at a court of law, the purpose of which is to grant, to the expropriated person, appropriate expropriation compensation. This is blatantly ignored by the Venezuelan government and the Venezuelan courts.

In the second place, an expropriation does not, as a general rule, entail the loss of the expropriated asset, until the expropriated person is paid the expropriation compensation within the context of the expropriation procedure before the court of law. However, in most cases, the properties are taken over by the government from day one. Under Venezuelan law, in order for the expropriating entity to be allowed to assume control of the expropriated asset, the expropriating entity must pay at the expropriation court an amount that is preliminarily considered to cover the value of the expropriated asset. This amount is called, in Spanish, “justiprecio” (an archaic expression meaning fair price), and is expressly required by the Expropriation Law, prior to the early takeover (*ocupación previa*). And this can only be done in some exceptional situations, in which the expropriating entity is exceptionally allowed to assume control of the expropriated asset, after paying the estimate and before the expropriated person is paid the final amount within an expropriation procedure at a court of law. In all other cases, the expropriating entity cannot take over the expropriated asset or company, not even by paying the estimate.

In the third place, many expropriations, particularly those made by PDVSA, which is the Venezuelan state oil company, were the result of PDVSA having ceased to make the payments that were due to its service providers, who could then refuse to continue to provide their services until the payments due to them were made by PDVSA, under the corresponding agreements. The government, anticipating any such refusal, took over, through PDVSA and its affiliates, the assets of its service providers. So the government abused its power to expropriate: this is called, in Spanish, “abuso de poder”, and, even though it is extremely difficult to prove, it can be invoked to challenge any governmental action. Indeed, in all cases, for the Administration to act, it must do so taking into consideration the reasons why it was empowered to act, in this case, to expropriate. An expropriation is a lawful means for the public sector to acquire rights over an asset, which is needed to satisfy the needs of the collectivity; an expropriation is not a lawful means to take control of assets the use of which should have been paid for under a contract.

In the fourth place, the government is in fact confiscating assets and companies, calling these confiscations expropriations, without having even budgeted the amounts needed to pay the expropriation compensations, and, with the complicity of the courts, ignoring that the prior occupation if applicable, requires a previously paid “justiprecio”. The government has undertaken many so-called expropriations, without paying anything, except in a few cases, and without any effective control by the judiciary, for several years now, so they are really confiscations. The government calls these confiscations expropriations, because confiscations are unconstitutional, except in cases in which the confiscated assets were used to commit a crime, which is not the case.

In the fifth place, when the expropriation courts do intervene, they normally do not comply with the Expropriation Law and other laws, which, for instance, require them to investigate the expropriated assets' situation in the corresponding real estate registries, and to thoroughly justify in writing, according to the applicable law, every decision and relevant procedural step they take.

In the fifth place, under the Constitution and the Expropriation Law, the government is supposed to pay a fair price for the expropriated assets, which often is higher than their book value. But, in the rare cases in which the government is willing to pay the expropriation compensation, it usually claims that it has to pay the book value. In fact, the Organic Law that Reserves to the State the Goods and Services in Connection with the Primary Activities regarding Hydrocarbons requires taking book value into account, contradicting the Constitution, which provides for a fair compensation, which implies taking market price into consideration. The requirement to apply the book value was established abusively by the government controlled National Assembly. This requirement was established assuming that the book value is inferior to the fair value. The relevant book value is that of the date of the expropriation, which, in a country with high inflation, like Venezuela, is very problematic, because, if and when the government pays for an expropriation, it pays several years later.

As a result of all the above, in present day Venezuela, the so-called expropriations, which are unconstitutional and illegal, are, nevertheless, probably the most common way for a company to change hands.

3. <u>Depressed market</u>:

Since, in present day Venezuela, these "expropriations" are very common, there is little room for ordinary mergers and acquisitions. It does not help that potential foreign and local investors are reluctant to invest, due to the nature the current Venezuelan government, which is very hostile to entrepreneurship and private property.

4. <u>MetLife and Atento</u>:

In spite of the above, our firm, Mendoza, Palacios, Acedo, Borjas, Páez Pumar & Cía., worked, very recently, in the following very important acquisitions:

In the year 2010, we assisted MetLife in an international transaction by means of which it acquired American Life Insurance Company (ALICO) from AIG, for approximately $15.5 billion. This transaction included the acquisition of 50% of Seguros Venezuela, which is a Venezuelan insurance company. And in the year 2011 we again assisted MetLife in the sale of its participation in Seguros Venezuela.

In 2012, we assisted the Spanish telecommunications company, Telefónica, with regard to the Venezuelan issues of the sale of its call-center group, Atento, to Bain Capital, in a global operation, for € 1.051 billion. Atento is the second-largest customer relationship management business in the world covering 15 countries and employing 152,000 people.

5. <u>The near future</u>:

Hugo Chávez was first elected President of Venezuela 14 years ago, at a time the oil prices went down to US$7 per barrel. Since then, he has been reelected three times,

and the price of oil has been around or above US$100 during most of his 14 years in office.

Venezuela's last presidential election, which was held on October 7, 2012, was won by President Chávez with 55% of the votes. The Venezuelan electoral system has been adversely criticized; for instance, the Carter Center's pre election report dated October 5, 2012, stated the following:

> ***Campaign publicity:*** *Venezuela law allows each candidate to buy three minutes of television spots and four minutes of radio spots per station per day. However, the law also allows the government to run free government institutional ads, which look very much like campaign ads, for up to 10 minutes per station per day. The National Electoral Council (CNE) has not defined government ads that defend official governmental policy as campaign publicity. Meanwhile, the CNE has defined opposition-sponsored criticism of government policy as equivalent to campaign publicity, and also banned some opposition-sponsored ads that criticize governmental policy. Furthermore, the president can command obligatory broadcasts of his speeches (cadenas), which has resulted in 40 hours and 57 minutes during the official campaign from July 1-Oct. 1. This situation has led opposition MUD to claim repeatedly that there is not equity in campaign publicity…*
>
> ***Use of state resources****: …NGOs monitoring the campaign have indicated broad use of government resources to support the Chávez campaign, such as vehicles to transport campaign workers and supporters...*
>
> ***Violence****: Violence at campaign rallies has been reported by the Capriles campaign as escalating in September. The most serious incident involved three people shot dead while participating in a closing campaign caravan for Capriles in Barinas State…*
>
> ***Voter security****: …the opposition MUD has reported concerns that past instances of voter intimidation from pro-government motorcycle gangs surrounding voting centers will be repeated on Oct. 7. In addition, they have expressed concerns that in the past, intimidation of party witnesses have left some voting tables without any opposition witnesses, allowing for potential manipulation, and their fears this could be repeated.*

Venezuelan voters were affected by the partiality of the electoral council (four out of its five members are open supporters of the government), and its inability to control government expenditure which could be seen as massive electoral bribery and massive use of governmental personnel and resources in President Chávez's campaign; as well as the authorities' intimidation of the more vulnerable voters. All these abuses were fruitful, since a very large percentage of the population depends totally on the government for its survival and is very ignorant, mainly because President Chávez destroyed the economy in his 14 years in office and Venezuela's educational system leaves much to be desired. Venezuela is an important oil producer, and the Venezuelan government employs or gives aid to a considerable segment of the population. A very large percentage of the population (approximately 60%, according to one study) does not believe in the secrecy of the vote (this is due to the fact that the machine that identifies the voters with their fingerprints is connected to the same computer as the machine in which the voters actually vote). Accordingly, a very large percentage of the population fears that it will cease to benefit from government jobs and governmental aids should it vote against President Chávez (there is a precedent for this: a prominent member of President Chávez's

party illegally obtained and published in the internet, with total impunity, the names of more than three million Venezuelans who had requested, according to the Constitution, a recall of President Chávez, and these more than three million Venezuelans were, for many months, denied access to the offices of many governmental entities, including PDVSA, and many of those who were government employees were fired). In addition, since President Chávez controls most of the television channels –except for one news channel that does not have a wide coverage–, the opposition's presidential candidate had difficulties getting his message through.

But there will probably be a change of government in Venezuela in the year 2013, due to President Chávez's illness.

The new president of Venezuela may be from President Chávez's party (*Partido Socialista Unido de Venezuela*: PSUV). Even in this case, there is a possibility that certain measures will be taken so that Venezuela becomes more attractive to local and foreign investors. In this case, there should be an increased activity in mergers and acquisitions. This possibility becomes a virtual certainty if the opposition's presidential candidate wins the election that will probably take place in 2013.

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