M&A 2010 – Dominican Republic

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1. What is the current level of M&A activity? Have you seen a pick-up in activity?

Despite all business sectors of our country being affected by the global financial crisis, the Dominican Republic has experienced an important economic resurgence during 2009 and 2010. In fact, the Dominican Republic had the largest increase of its percentage of gross domestic product (GDP) in Latin America (a growth rate of 7.5 per cent) for the first semester of 2010, and held its inflation below of what was expected by the International Monetary Fund (IMF) through its stand-by agreement.

Therefore, this progress has been reflected in merger and acquisition transactions: the level of cross-border and local deals by corporations was significant in 2009 to 2010, as will be referred to in question 2. We must emphasise, however, that during the crisis, the Dominican Republic did not experience a complete decline in M&A transactions, considering that various opportunities for business and investments were generated as a consequence of the crisis, especially in the industries that continued with vigor during the global crisis period (food, beverage, retail, and mining, among others).

2. Please describe some of the most noteworthy (in legal or economic terms) recent deals in your country.

The acquisition of the Shell Business in the Dominican Republic was one of the most significant deals in our country in 2009. The transaction consisted in the joint acquisition by the Vicini Group (Finerty Properties Corp) and the Sol Group (Sol Investments Limited) of the ownership interest of the Royal Dutch/Shell Group in the Dominican Republic branch of The Shell Company Limited.

The Shell business in the Dominican Republic was primarily focused on the distribution of fuels and the sale of lubricants, in each case to the retail and commercial sectors in the Dominican Republic. OMG assisted the Vicini Group in this transaction, which included negotiation of the joint venture agreement, as well as issues pertaining to the purchase agreement with Shell.

In addition, Cervecería Nacional Dominicana, a company of the León Jimenes Group, signed a purchase agreement with the Danish company Royal Unibrew for 1.122 billion Dominican pesos to acquire its majority stake in the operation, production and marketing of beers, malts, sodas and water in Saint Vincent, Antigua and Dominica. This operation was perceived as a strategy of Cervecería Nacional Dominicana to increase its foreign income, as well as to export their brands to the CARICOM market.

Another noteworthy deal was the acquisition by Venezuela of a 49 per cent stake in the Dominican state-owned Petroleum Refinery (REFIDOMSA) for US$131.5 million. Under the agreement, the Dominican Republic’s government kept control of REFIDOMSA’s administration, which has a refining capacity of 34,000 barrels per day. The formalisation of the acquisition was on May 5 2010.

In addition, on August 10 2010, Corripio Group, Vicini Group, Rizek Group, and the Bermúdez Group acquired the majority stake (91.44 per cent) in one of the leading Dominican newspapers, Editora Listín Diario, C. por A. (ELD). The transaction included the previous restructuring of ELD’s outstanding debt with its creditors for US$38,500 million.

Finally, we must mention the process of recapitalisation that was concluded by Tricom, a Dominican telecom and data communication company, as will be discussed in more detail in question 8.

3. Which industries will see the most M&A activity this year?

We predict that the industries that may experience the most M&A activity are construction, tourism, mining, telecom, energy, banking, food, beverage and retail. These industries are expected to experience a pick-up due to the predictable growth and expansion of such markets considering that one of the main strategic targets of the core Dominican companies is to be able to consolidate or expand their business locally and towards international markets.

Furthermore, we believe that construction (infrastructure projects) and energy sectors could experience a significant growth in M&A given that our country has a strategic location to develop aid relief projects for the damages of the 2010 Haiti earthquake. In particular, the construction industry is expected to maintain its pick-up due to the upkeep of the low loan interest rates since the beginning of 2010.

4. What types of deals do you expect to see? (Minority investments, joint ventures, outright or total acquisitions, etc.)

We expect upscale acquisitions from foreign and local investors by the end of 2010, considering that there will be a healthier political and economic environment for local and international business. Local investors and operators may also venture into minor acquisitions in order to diversify their business and penetrate other markets. We also expect mergers and acquisitions to consolidate synergies in operations and to reduce costs. In particular we anticipate an upward trend in acquisitions in the banking sector.

Finally, we expect, although to a lesser extent, outbound investments of local funds through mergers or joint ventures with foreign companies.

5. Do you expect to see many (incoming and outgoing) cross-border deals, whether they involve companies and investors from other countries in Latin America or from outside the region?

Outgoing cross-border deals are still incipient in the Dominican Republic. To some extent, the local business community has been conservative in this regard. We should point out, though, that the internal market expansion experienced by the Dominican Republic has kept the local companies focused on opportunities regarding their local operations and in certain cases, trying to keep up with demand.

However, companies with overseas growth potential and aggressive expansion plans do exist. Hence, future outgoing M&A activity by Dominican investors is a possibility. In relation to incoming cross border deals, given the country’s high consistent levels of FDI it is likely that some of the investments
carried out in the Dominican Republic would take the form of an M&A transaction, but this will depend on the strategic decision of the investors.

Traditionally, the United States, Spain, Canada and the United Kingdom have been responsible for most of the FDI inflows in this country. More recently, there have been significant inbound investments coming from Mexico, Brazil and Venezuela.

In regards to Venezuela, it is of interest to note that over the past four years FDI from that country has been increasing significantly. These investments have been performed in some cases by acquisition of existing businesses or assets. The current level of FDI does not necessarily reflect the potential of new deals coming from this neighbour country.

Prominent Venezuelan businessmen have expressed their interest in the Dominican Republic as an investment location, after having performed the pertinent market studies in the region. It is very likely that M&A deals could take place in relation to these Venezuelan plans of expansion.

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

At least 95 per cent of the equity activity in the Dominican Republic is private. At the moment international funded equity has a significant participation in the leading local companies, mostly in tourism, manufacturing of goods, construction, mining, energy and telecommunications.

7. Have you seen any easing in the credit crunch’s effect on M&A activity? Is financing available for deals?

Our financial system was not greatly affected by the credit crunch given to the fact that Dominican banks are not anchored by US banks, and that our banking sector had already been restructured as a result of our 2003 banking crisis; consequently this sector was already under restrictive monetary and financial policies and regulations that did not allow our banks to undermine to the global financial crisis.

However, the negative effect of the global financial crisis was certainly perceived by the Dominican Republic economy, especially in the foreign investments funded with foreign financing as well as in the DR exports. Nevertheless, these effects have been successfully overcome, as a consequence of the economic resurgence experienced in 2009. Consequently, reasonable financial conditions and opportunities exist to partake in the local market in a cost-effective manner.

8. Has there been an increase in M&A activity involving financially troubled companies?

In the last year very few relevant cases of M&A involving financially troubled companies came out to public knowledge, one of them was the case of Tricom, a leading Dominican company in the field of Telecom and Data Communications which recently concluded a financial recapitalisation process that lasted more than six years and began when the company declared itself unable to repay financing contracted with various international financial institutions.

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 reorganisation and liquidation bill of law is under review by the Dominican Congress. The proposed law envisages a reorganisation procedure, which could under certain conditions lead to sale of the business as a going concern, giving an important role to the creditors. This proposal takes into account the special regimes that govern certain regulated sectors in this matter.

Currently in some sectors the insolvent business may be sold after the authorities become aware, or are informed, of this situation. For instance, the Monetary and Financial Law provides a regularisation procedure for financial entities in cases of reduction of their assets, or in their coefficient of solvency, and in other pre-insolvency situations. In these cases the regularisation plan may include the implementation of a sale, merger or capital raise subject to the approval by the authorities.

In addition, the regulation on dissolution and liquidation of financial institutions issued pursuant to provisions of the Monetary and Financial Law allows the Superintendency of Banks to transfer assets owned by the institution subject to the proceedings. Under the said regulation, operations of the financial entity are suspended with the commencement of the dissolution process.

10. What other types of activity are resulting from the economic situation? (For example, the restructuring or exchange of debt, the sale of non-core businesses, activist shareholders.)

A few exceptions aside, in the last year it has not come to public knowledge that relevant activities of such type have resulted from the underprivileged economic situation of local companies.

11. More generally has there been any increase in hostile takeovers and shareholder activism? What defences and responses are target companies using? Have companies in your country implemented shareholder rights plans (‘poison pills’) or other anti-takeover protections?

Even though there have been important developments in the public securities market in the Dominican Republic, not having defined separation between ownership and control in the structure of our public companies constitutes a restriction for the existence of a market for corporate control.

Certain factors have limited the development of a market for corporate control in the Dominican Republic. To begin with, concentrated ownership has been a constant characteristic of Dominican companies. We should also highlight that the finance of private sector operations in the Dominican Stock Market does not comprise the so-called ownership instruments. It has been argued that this is the consequence of the lack of adequate incentives for companies to offer their stock to the public, together with the fact that the Dominican corporate culture has not evolved to a level that would allow them to go public.

Promoting the ideas that have supported the system in other countries alone would not induce Dominican companies to disperse their ownership through the stock market.

In that regard, indubitably, having to comply with disclosure and fiscal transparency requirements has discouraged several local companies to carry out IPOs in the Dominican Stock Market. Making companies aware of the fact that these requirements are not exclusively related to carrying out activities in the stock market – due mainly to legal and regulatory developments – could probably lead, to a certain extent, to raise the participation of private companies in the stock market.

Currently, these requirements should be taken into account not only when considering raising capital in the stock market, but also whenever doing business through a corporate vehicle. For example, in relation to disclosure, according to provisions of the new Corporate Law, companies should reveal their ownership stakes. With regards to improvement of the fiscal transparency of companies, this has been a relatively recent achievement of the implementation of sound tax policies by the authorities.

With regards to investors, the performance of the Dominican Stock Market would improve significantly if Pension Funds Administrators were allowed to raise their current levels of investments in the publicly traded instruments, taking into account that they handle very important amounts. Since 2003 the Pension Funds Administrators have been diversifying their investments and as a result they have invested in instruments issued in the stock market. Nevertheless, risk-bearing by these institutions is restricted and this type of investment by Pension Funds Administrators has been permitted to a reduced level.

We would like to note though, in regards to anti-takeover protections, that preemptive rights and preferential subscription rights are usually included in the bylaws of the Dominican companies. This mechanism could work as takeover protection and hinder or prevent hostile takeover attempts. However, restrictions established by the new Corporate Law may apply.
12. Have directors changed how they conduct themselves in M&A deals? Should directors and management be more concerned today about negative publicity, shareholder criticism, regulatory pressure and liability from potential litigation? From your experience, are directors more diligent today in their review of M&A transactions and other matters?

In this area there have been some recent developments. The new Corporate Law extends the fiduciary duties of directors owed to the company and its shareholders and provides for sanctions for noncompliance. Thus, directors would be inclined to conduct themselves more appropriately to minimise possibility of civil liability or even imprisonment.

In regards to the regulated sectors, the Monetary and Financial Law provides for fines and imprisonment of members of the board of directors who alter or conceal information to impede the performance of supervisory functions by the Superintendency of Banks, or who approve or present false balances or financial statements, or give approval to transactions carried out to purposely hide information concerning the financial situation of the institution.

Directors and managers can be subject to these sanctions according to the provisions of the said law, in cases of dissolution processes, when they enter into contracts that alter the amounts of assets held by the financial institution. In addition, individuals that carry out managerial functions in financial institutions can be subject to punitive administrative sanctions established by the Monetary and Financial Law if they infringe its provisions or any regulation issued pursuant to its rules.

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?

In our experience, complex M&A transactions for domestic deals are usually handled with very international standardized agreements, due to its consistency with the Dominican contract law. In cross-border M&A deals involving shares of a Dominican company or assets established in the Dominican Republic subject to special registration, additional documents are drafted and included as exhibits to the main agreement to comply with local legal and regulatory requirements, such as transfer declarations and securities.

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?

1. The performance of a legal and financial due diligence is always advisable: Conducting detailed investigation is essential to determine if there are any existing or potential liabilities affecting a company or its assets, as a consequence of non-compliance with regulatory, corporate, tax, labour, and environmental regulations and policies. Investors shall pay special attention to title of ownership, tax situation of the company and to the compliance with Dominican labour regulations.

2. Election of the most efficient transfer structure following the results of the due diligence: In our experience, it is preferable to execute an acquisition transaction as an assets deal rather than a share purchase, in order to reduce contingencies only to labour and tax liabilities. Shares acquisition is preferable in cases where the company owns non-transferable (or of restrictive transferability) assets or rights, such as a state grants.

3. Execution of pre agreements (letter of intent or MOU) and negotiation of post closing guarantees: It is advisable to agree on the terms and conditions that will rule the acquisition, including representations and guarantees of the seller, condition precedents, conflict resolution and walkout clauses. In addition, we strongly advise negotiation of post closing guarantees for inconveniences and liabilities that may arise after closing, either from any false representation or from the non-compliance with the terms of the purchase agreement (hold back or escrow payment).

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

In regulatory terms, the tax authority has become more sophisticated and in practice it has imposed restrictions on allowing a tax-free reorganization according to article 323 of the Tax Code. Consequently, company’s accounts should be presented properly, taking into consideration potential capital gain liabilities. Therefore, structuring the M&A transaction would necessarily entail performing tax planning. Before engaging in the deal the companies involved would need to develop a proper fiscal structure.

Moreover, given the active involvement of the tax authority in this type of transaction and the possibility of having conflicting interpretations with regards to the legal provisions related to the tax liabilities in respect to the prospective deal, consulting with the tax administration at an early stage in order to obtain a ruling concerning the applicable tax treatment could be convenient. This would depend on the fiscal structure and the level of compliance of the companies involved given that this course of action may trigger audit procedures by the authorities.

In fact, tax issues may delay the completion of M&A transactions. Litigations have occurred when there has been a disagreement regarding the scope of the tax liabilities arising from the transaction. It is important to note that the authorities are very diligent in these matters and have taken action even before the transaction has been carried out.

Concerning legal developments, minor changes to the M&A process with regards to mergers and spin-offs have been established by the new Corporate Law for private equity and public security deals.

16. Please (briefly) describe how the competition regime in your country affects M&A transactions. Have there been any significant recent developments or cases?

The recently enacted Competition Law does not envisage an antitrust review for M&A transactions. However, attaining market power through an acquisition or a merger may be relevant in regards to the antitrust regulator analysis of cer-

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tain practices for the purposes of applying abuse of dominant position provisions of the referred law. In these cases the authorities must take into consideration the requirement of the existence of an abuse for the behaviour to constitute a violation. Thus, dominant position by itself does not constitute a violation.

It is convenient to note that the competition regime has not been fully implemented given the antitrust authorities are yet to be appointed. However, there are competition rules under the regulatory regime of certain sectors. That is the case, for example, of the regulations issued pursuant to the Electricity Law according to which concentrations involving electricity generation companies are subject to the regulator's approval. Merger control provisions are also in force in regulations of the Telecommunications Law.

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

Mergers and spin-off contracts involving public companies are subject to review by the public securities regulator under the new Corporate Law. In addition, provisions of new laws and regulations applicable to specific sectors should be taken into account when considering engaging in M&A activity. For instance, in the electric sector the transfer of governmental concessions carried out by means of a sale, rent, transfer, transformation, absorption, or merger of companies, is subject to regulatory approval. In the banking sector mergers, absorption, spin offs, substantial disposal of assets and shares, and similar transactions, are subject to approval by the authorities. Moreover, under the social security regime mergers of Pension Funds Administrators are subject to approval by the Pensions Superintendence.