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The Legal 500 Country Comparative Guides

Ecuador

MERGERS & ACQUISITIONS

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This country-specific Q&A provides an overview of mergers & acquisitions laws and regulations applicable in Ecuador.

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1. What are the key rules/laws relevant to M&A and who are the key regulatory authorities?

In the Ecuadorian legal context, the term merger means the process by which (i) two or more companies combine into a new single entity, or (ii) an entity absorbs another entity which ceases to exist. While a merger requires regulatory approval, the acquisition of one or more entities that is carried out through the transfer of shares issued by the acquired entity is not subject, in general, to any regulatory approval.

For the purposes of this questionnaire, M&A will be used as a generic reference to either mergers or acquisitions effected by way of a share transfer; merger will be used in its specific legal definition and SPA will designate share transfer transactions.

Regarding private companies, mergers are regulated in the Companies Law and the regulatory authority is the Superintendence of Companies, Securities and Insurance (SCSI), which must approve them. Acquisitions of assets and liabilities are not subject to approval by the SCSI.

Mergers of publicly traded companies are regulated by the Securities Market Law and the regulatory authority is the SCSI.

Mergers of companies that are part of the financial sector, including Fintech companies, are regulated by the Organic Financial Code and the regulatory authority is the Financial Policy and Regulatory Board.

Regarding antitrust and competition, there is a mandatory M&A notification regime when the economic operations exceed the thresholds established by law. The authority is the Superintendence of Control of Market Power (SCPM).

The minimum thresholds that require mandatory notification are:

a. If the sum of the total volume of sales in Ecuador of the participants in the transaction exceed the amount determined by the Regulatory Board of the Competition Authority (currently: US$ 1,472,000,000.00 for companies that are part of the financial system and publicly traded companies; US$ 98,440,000.00 for insurance and reinsurance companies; and, US$ 92,000,000.00 for companies in sectors other than those mentioned above);
b. In case of concentrations involving economic operators engaged in the same economic activity and, as a consequence of the concentration, an equal to or greater than 30 percent quota of the relevant market of the product or service is acquired or increased within the country or in a geographic market defined within it.

2. What is the current state of the market?

The SCPM processed 21 concentration notifications in 2021 (annual report 2021) and 34 concentration notifications in 2022 (annual report 2022). The 2023 report has not yet been published by SCPM.

3. Which market sectors have been particularly active recently?

The main sectors that have seen M&A activity are telecommunications, health services, food, air transportation and non-traditional agroindustry exporters.

4. What do you believe will be the three most significant factors influencing M&A activity over the next 2 years?

The resource potential of the Country. Ecuador has become the new mining frontier, with most of its territory largely unexplored and available for mining permits. Abundant water sources and geological conditions are also promoting a new wave of

investments in PPP projects for renewable energies.

Distressed companies up for grabs. The economic outlook is grim. According to World Bank forecasts and other analytical sources, Ecuador's GDP will grow 0.8% in 2024; fiscal deficit may well reach 8%, country risk sits at 1675 basic points, and the public debt-GDP ratio has exceeded the legal threshold, meaning that more Government debt is not an option to finance economic growth. Government contractor companies who depend on a great extent on Government payments will be up for grabs, and so will be companies that are highly leveraged or struggling with cash flow in the context of a shrinking economy. Ecuador will also continue to open up foreign investment opportunities. Clearly all of this and other factors are giving rise to opportunities in a buyer's market.

5. What are the key means of effecting the acquisition of a publicly traded company?

M&A transactions for publicly traded companies are very uncommon in Ecuador. The vast majority of transactions involve only private companies.

Our legislation contemplates: Primary public offering of securities is one that is carried out with the objective of negotiating, for the first time, in the market, securities issued for that purpose.

Secondary public offering of securities is one that is carried out with the objective of negotiating in the market, those securities that have been previously issued and placed.

Primary public offering. The following companies may carry out a primary public offering of shares:

1. Corporations and mixed economy companies that are founded through successive constitution or public subscription of shares.
2. Existing corporations and mixed economy companies that carry out capital increases through public subscription.

For the authorization of the public offering and registration of shares in the Public Registry of the Securities Market, the documentation established in the local legislation must be submitted.

Secondary public offering of unregistered shares will be subject to a previous registration process, for which a certified copy of the minutes of the general meeting of shareholders will be submitted, in which the registration of the shares was decided and the corresponding informational prospectus. The content of the latter will be established for the public offering prospectus for increases in capital through public subscription of shares, where applicable.

Acquisitions of shares or debentures convertible into shares that enable the taking of control of a company, in a single act or in successive acts, or that enable a person or group of persons to acquire directly or indirectly a significant interest in the voting shares of a given company must be subject to the procedure of mandatory tender offers. Significant participation is one that alone allows decision-making in the management of the company.

The takeover of public companies listed on the stock exchange is carried out through public tender offers that are regulated in the Securities Market Law.

If the transaction implies a market concentration, the M&A requires notification and approval by the SCPM. The responses to Q1 refer to the thresholds and criteria to determine whether a particular transaction may result in market concentration.

6. What information relating to a target company will be publicly available and to what extent is a target company obliged to disclose diligence related information to a potential acquirer?

Ecuadorian companies are registered in the SCSI. Complete corporate information is publicly available, including its corporate structure and its annual financial reports.

Publicly available information includes the names of shareholders and their participation in the company, financial statements, bylaws and corporate acts such as capital increases; certificate of compliance with the SCSI.

Regarding other public entities, available information includes compliance and good standing statuses, particularly as they related to social security, corporate regulatory and tax compliance. Claims filed by or against a company are also available on-line.

For publicly traded companies, in addition to the prospectus, they must submit economic and financial information such as:

a. Description of the economic environment in which it has been and will continue to develop its activities with respect to the sector it belongs to.
b. Main lines of products, services, businesses and activities of the company.

c. Detail of the main productive and unproductive assets.
d. Description of investment and financing policies for the last three years and for the next three years; or since its inception, if its seniority is less.
e. Audited financial statements with their respective audit report, for the last three fiscal years, individual and consolidated when applicable.
f. Horizontal and vertical analysis of the financial statements for the last three years.
g. For the same period as stated above, at least the following financial indexes:
    1. Liquidity.
    2. Current ratio minus accounts receivable turnover.
    3. Leverage.
    4. Return on investment.
    5. Gross profit margin on sales.

7. To what level of detail is due diligence customarily undertaken?

The level of due diligence will depend on several factors compounding a risk assessment at the outset, such as industry sector, size of the company, financials, complexity of operations, corporate ownership and governance, purchaser's corporate policy, among others. Usually, in a first stage, a high level (red flags) due diligence is undertaken, and a deeper and comprehensive due diligence is performed if warranted by the initial findings. However, when either the purchaser or the target is a public company (listed in a stock exchange), due diligence will have to be comprehensive and thorough, in order to satisfy the standard of care and fiduciary responsibilities imposed on governance bodies.

8. What are the key decision-making organs of a target company and what approval rights do shareholders have?

The key decision-making organs of a company are the General Shareholders' Assembly and the Board of Directors.

Only the general shareholders' meeting has the power to approve a merger. This approval can be decided by simple majority; however, the company's bylaws may require a qualified majority. Once the announcement of a tender offer has been made, the general meeting or its board of directors may not, during the entire term of the tender offer, resolve on mergers or spin-offs.

Creation of the Board of Directors is optional. According to a legal reform incorporated on January 23, 2023, in boards of directors of 3 or more persons, at least one of them must be a woman.

9. What are the duties of the directors and controlling shareholders of a target company?

The administrators of the company have the duty to comply with the laws, regulations, bylaws and other applicable regulations, with the diligence of an orderly businessman, taking into account the nature of the position and the functions attributed to each of them. For such purposes, the administrators shall have the appropriate dedication and shall adopt the necessary measures for the good management of the company.

In accordance with the rule of discretion, in the area of strategic and business decisions, the standard of diligence of an orderly businessman shall be deemed to be met when the administrator has acted in good faith, without personal interest in the matter being decided, with sufficient information and in accordance with an appropriate decision-making procedure.

They must also comply with the duty of loyalty which obliges them to:

(a) Not to exercise their powers for purposes other than those for which they have been granted.

b) To keep the information secret, including data, reports or background information to which she has had access in the performance of her duties, even when she has left office and for up to one year from the date of leaving office, except in those cases in which the law permits or requires it.

c) Refrain from contracting or negotiating, directly or indirectly, with the company she manages, except for the exceptions provided by law;

d) To perform its functions under the principle of personal responsibility with freedom of criteria, judgment and independence with respect to third parties; and,

e) Adopt the necessary measures to avoid incurring in situations in which their interests may conflict with the corporate interest and with their duties to the Company.

10. Do employees/other stakeholders have any specific approval, consultation or other

rights?

There is no approval, consultation or other special rights granted by law to employees or other stakeholders. However, additional voting rights may have been granted to certain shareholders or minority shareholders under shareholder agreements.

11. To what degree is conditionality an accepted market feature on acquisitions?

Conditionality is indeed an accepted market feature depending on the industry sector, risk profile, governance considerations, regulatory roadblocks, material contracts that may be impacted and other factors. SPA terms and conditions are mainly subject to party autonomy.

12. What steps can an acquirer of a target company take to secure deal exclusivity?

Exclusivity is usually included in a Letter of Intent or any other preliminary document or heads of agreement of the transaction. In non-binding letters of intent, certain exceptions are given mandatory effects, including exclusivity provisions, confidentiality and arbitration.

13. What other deal protection and costs coverage mechanisms are most frequently used by acquirers?

An indemnity for the non-closing of a transaction is often included in Letters of Intent and other preliminary documents, as well as break-up fees. It is highly recommended to carefully craft the reps & warrants, indemnity and limitation of liability provisions, which should ideally offer the purchaser the right to claim a price reduction on Closing if certain conditions are not met or key valuation assumptions are not confirmed.

14. Which forms of consideration are most commonly used?

The most frequent consideration is cash. However, in large acquisitions in the resource and energy sectors, a share exchange is usually considered, where the target company shareholders receive shares issued by the purchaser in addition or in liu of cash. In any case, consideration with shares or other assets may be accepted, without any limitation in this respect (i.e. party autonomy).

15. At what ownership levels by an acquirer is public disclosure required (whether acquiring a target company as a whole or a minority stake)?

The Superintendency of Companies and the Stock Exchanges must be informed five business days prior to any share acquisition transaction:

– Shareholders who directly or indirectly or through third parties hold ten percent or more of the capital of a company registered in the Public Registry of the Stock Exchanges, or who as a result of an acquisition of shares come to hold such percentage.

– The administrators of such companies, whatever the number of shares they acquire.

16. At what stage of negotiation is public disclosure required or customary?

In a process of M&A involving private companies, the negotiation and closing is usually confidential. Public disclosure is discretionary and driven by market considerations mainly.

Regarding public companies, transfers of shares registered in the Public Registry of the Stock Exchanges originating in mergers, spin-offs, inheritances, legacies, donations, contributions among other cases which are not made through the stock exchanges must notify the stock exchanges of such transaction within 24 hours after the transfer of ownership of the registered securities is completed. The stock exchanges must immediately release such information to the entire market.

17. Is there any maximum time period for negotiations or due diligence?

Whether for private companies or public companies listed on a stock exchange there is not a legal limitation, and due diligence period are subject to party autonomy.

Regarding due diligence, it usually lasts between 30 and 90 days, depending on the company. Heavily regulated target companies with highly complex operations, such as a financial entity, may take up to six months. Normally a Letter of Intent or a Memorandum of Understanding is signed, after which the due diligence begins and at its conclusion the closing of the transaction takes place.

18. Are there any circumstances where a minimum price may be set for the shares in a target company?

In public companies, the shareholder who has taken control of a company may not, within twelve months from the date of this operation, acquire shares of the company at a unit price per share lower than that paid in the takeover operation.

If within the thirty-day period prior to the effective date of the offer, the offeror has acquired the same shares included in the offer, at price conditions more beneficial than those contemplated in the offer, the shareholders who sold them prior to the tender offer will have the right to demand the difference in price or the benefit in question.

19. Is it possible for target companies to provide financial assistance?

There is no prohibition that prevents the target company from giving this assistance to its shareholders, however a company cannot use its resources except to fulfill its corporate purpose. In this sense, the target company could not use its resources to support its shareholders or the buyer itself.

20. Which governing law is customarily used on acquisitions?

While the merger process, the transfer of shares, regulatory notifications or approvals and other discrete aspects of an M&A process are naturally governed by Ecuadorian laws, the transaction as a whole (i.e. SPA agreements, preparatory contracts, NDAs, other transaction documents) may be subject to the laws chosen by the parties. The choice of foreign laws, typically of the laws where the buyer has its main place of business, is frequent.

21. What public-facing documentation must a buyer produce in connection with the acquisition of a listed company?

Public tender offers are irrevocable. Notwithstanding the foregoing, the natural or legal person making the tender offer may contemplate objective grounds for the expiration of its offer, which shall be included both in the notice and in the tender offer circular.

Takeover bids may only be modified during their term to improve the price offered or to increase the maximum number of shares offered to be acquired. Any increase in the price will also favor those who have accepted the tender offer at its initial price.

A guarantee must be constituted for a percentage of the total amount of the offer, as determined by the Monetary and Financial Policy and Regulation Board, which may consist of money or securities issued or to be issued. This guarantee will remain in the custody of a financial institution or of the centralized securities clearing and settlement depositories.

22. What formalities are required in order to document a transfer of shares, including any local transfer taxes or duties?

The transfers of shares are made through a letter of assignment signed by the assignor and the assignee, along with the tender and endorsement of the share certificates. The signing officer of the target company must register the transfer in the Company's Corporate Books, cancel the share titles and issue new titles in favor of the new owner of the shares. Technically, the transfer of shares is enforceable vis a vis third parties upon registration of the transfer in the corporate ledger.

The transfer of shares or other rights representative of capital interests in a business venture may give rise to capital gain taxes ("CGT"), regardless of whether the shares in question may have been issued directly by an Ecuadorian entity, or by a foreign parent company at some level in the corporate ownership chain, to the extent that (i) at least 20% of the value of the foreign parent company is derived, directly or indirectly, by the value of the Ecuadorian subsidiary, and (ii) the aggregate price paid within a given year for direct or indirect holdings of the same company exceed a certain threshold, currently US$ 3.5 Million. It should be noted that when the seller is a foreign company with no tax residence in Ecuador, tax laws impose on the local subsidiary the obligation to file the tax forms and pay the capital gains taxes in substitution of the seller. Tax indemnities and escrow arrangements are therefore a common feature in SPA agreements.

23. Are hostile acquisitions a common feature?

No, hostile takeovers are not usual in Ecuador.

24. What protections do directors of a target company have against a hostile

approach?

Since there are no hostile takeovers in Ecuador, Boards do not usually take action to prevent these types of acquisitions, however, several of the options that the Board may take could be:

- Compensation packages in the event of a change in control.
- Additional shares to existing shareholders, diluting the value of their holdings.
- Staggered boards, which limit the ability of an acquirer to replace the entire board of directors at once.

25. Are there circumstances where a buyer may have to make a mandatory or compulsory offer for a target company?

No, unless the buyer has subjected himself to such an obligation by contract.

26. If an acquirer does not obtain full control of a target company, what rights do minority shareholders enjoy?

In addition to other rights that may be recognized in the bylaws or shareholder agreements, some of the rights granted by the law to shareholders are:

1. Minority shareholders who own at least five percent of the share capital may request, only once, the inclusion of matters on the agenda of a general meeting that has already been called, to deal with the points indicated in their request. .
2. The shareholder(s) representing, individually or jointly, 5% of the share capital may initiate, on behalf of and in defense of the company's interest, the corporate liability action when it has not been filed within one month, counted from the date on which the general meeting agreed to exercise the corresponding action. The shareholders may directly exercise the corporate liability action when it is based on the breach of the duty of loyalty, without the need to submit the decision of the general meeting.
3. For the shareholders representing at least 15% of the share capital, they may request, by any means, whether physical or digital, and at any time, the administrator or statutorily corresponding body, the convening of a general meeting of shareholders. to deal with the issues you indicate in your request.
4. A minority representing no less than twenty-five percent of the total paid-in capital may appeal the decisions of the majority.
5. Shareholders representing at least 20% of the integrated capital may request the Superintendency of Companies to intervene by appointing an expert to verify the truth of the balance sheet and other documents presented by the administrator.
6. The SCSI may declare the intervention of the company and will designate one or more intervenors for it: If requested by one or more shareholders representing at least 10% of the company's paid capital, stating that they have suffered or are at risk of suffering serious damage due to noncompliance or violation of the Law, its regulations or the company's bylaws, incurred by the company or its administrators.
7. In Simplified Stock Companies (SAS), the clauses in relation to the restriction to the trading of shares, authorization for the transfer of shares or for the resolution of corporate conflicts through mediation or arbitration, may only be included or modified through the unanimous resolution of the holders of one hundred percent (100%) of the capital stock.

27. Is a mechanism available to compulsorily acquire minority stakes?

Mechanisms to compulsorily acquire minority stakes may be included in the bylaws or shareholder agreements.

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