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Regulation of M&A transactions in the financial services industry in Costa Rica

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The year 2007 made our forecasts of last year come to fruition. GE Money, Citibank, HSBC and Scotiabank intervened in the acquisition of stakes in several leading Central American financial institutions, including BAC, Grupo Financiero Uno, UBC (Banco Cuscatlán), Primer Banco del Istmo and Costa Rica's wholly-owned national private banking bastion, Banco Interfin

Mergers of banks and other financial intermediation institutions are governed by diverse legislation, including corporate and regulatory laws and regulations. This article is a summary of these laws and regulations and their impact on banks' and other financial intermediation institutions' M&A activity (FI acquisitions).

Regulatory implications of the merger or acquisition

An FI acquisition only requires that the Costa Rican General Superintendent of Financial Institutions (the regulator) is sent notice of the transaction, regardless of whether it involves a stock purchase, a merger or a sale of assets. The regulator does not have express statutory authority either to approve or to reject an FI acquisition. However, it is necessary to provide the regulator with information regarding the ownership of the entity, in order to determine the ultimate beneficial or direct ownership by physical persons. It is also necessary that the Financial Services Regulatory Council (Conassif) approves true statutory mergers.

Approval by the regulator

In cases where the transaction involves a transfer of an ownership stake of more than 10% of

the FI's total equity, the regulator must request information about the acquirer. The regulator may exonerate acquirers from filing information when they are public entities or international multilateral institutions, or if they are well known entities whose stock is traded.

Approval by Conassif

Conassif must give prior approval for any planned merger of FIs. After the approval is given, the FIs must take the necessary corporate resolutions to complete the merger.

M&A activities of financial institutions from the perspective of corporate law

Statutory procedures

M&A activities have specific regulations depending on the form they take. The procedure involves similar steps to the regulation of mergers in other jurisdictions:

- (a) an agreement by the shareholders of each of the merging entities;
- (b) a merger agreement;
- (c) the publication of the merger; and
- (d) the issuance of articles of incorporation for the resulting entity.

M&A through the acquisition of shares of stock in a company is not expressly regulated, except through certain protections to minority shareholders and limitations to the transfer of share ownership interests.

Finally, bulk transfers of assets are regulated by a procedure whereby there is:

- (a) an agreement between seller and purchaser under statutory requirements;
- (b) the transaction's documentation in a public deed;
- (c) the publication of the transaction, for the benefit of creditors; and
- (d) a statutory escrow procedure for payment, whereby the purchase price is deposited with an independent party (such as a notary) who holds funds and disburses them to the seller after his duly accredited creditors are paid off.

M&A: focus on minority shareholders' rights

Aside from the foregoing procedures, M&A activity requires parties to focus on minority

shareholders' rights. Costa Rican law contains a few protective provisions, but allows parties to create substantial protections for minority shareholders. There are no special corporate minority shareholders' rights per the laws and regulations related to the financial market.

Costa Rican corporate laws establish basic information and participation rights for minority shareholders, including:

- Inspection of corporate and financial records at any time, giving proper advance notice and in preparation for General Shareholders' Meetings.
- Owners of at least 20% of the share capital may demand an audit of the company's financial statements and operation, at their own expense.
- Holders of a 25% stake may demand the competent company directors or management to convene a General Shareholders' Meeting.
- Holders of a 20% stake may also demand a maximum 72-hour suspension of the General Shareholders' Meeting and further information, and clarification from the management of issues to be decided at the meeting.
- A single shareholder may demand a General Shareholders' Meeting be convened if no annual meetings have been held during two consecutive periods.

Costa Rican corporate laws allow the inclusion of special restrictions to share transfer rights to protect minorities, including rights of first refusal, tag-along rights, drag-along rights and preemptive rights on stock issues. These provisions are not of mandatory inclusion, but shareholders and partners may build them in to their corresponding corporate structures. There is little case law from courts in relation to such provisions, but as M&A activity continues to expand, the enforcement of such provisions and their discussion in judicial and arbitration proceedings will be a key source of law and regulation.

The diversity of laws and regulations applicable to M&A in the financial sector – together

with the absence of enough practice in the areas of corporate and financial regulation – presents market agents, regulatory authorities and practitioners in Costa Rica with significant challenges in the near future. So far, the Costa Rican regulatory authorities have followed a permissive stance, a symptom of a policy decision to welcome the entry of these global financial players into the market. The regulators' approach remains to be confirmed.

Financial and corporate

Recommended firms

Tier 1

Arias & Muñoz
Facio & Cañas
Zürcher Odio & Raven

Tier 2

BLP Abogados
Consortium – Laclé & Gutiérrez
Pacheco Coto

Tier 3

Aguilar Castillo Love
Batalla & Asociados
Lara López Matamoros Rodríguez & Tinoco
Nassar Abogados

Tier 4

André Tinoco Abogados
Feinzaig Scharf van der Putten
KPMG Abogados
Oller Abogados
Pacheco Odio & Alfaro

The expected ratification of the Central American Free Trade Agreement (Cafta) in November is considered a foregone conclusion by many. The transition to a new government in 2006 seemed to produce only positive effects, with continued stability in the country. This has helped encourage foreign investors, with several economic sectors enjoying an influx of money.

The banking sector is the most obvious, as foreign banks continue to swoop into Costa Rica (and the rest of Central America). The list of new financial entities moving into Costa Rica is quite impressive: Citibank, HSBC, Scotiabank and GE Capital are some of the recent entries.

Real estate development has been booming, as both institutional buyers and wealthy individuals acquire property, particularly on the coasts. Coincidentally, a marked increase in tourism has led hotels and resort developers to also buy property to host their visitors. For Costa Rican law firms, this means more business.

Costa Rica has also been part of a unique trend that has emerged: the regionalization of firms across Central America. Cafta has meant new region-wide investments, and several firms are looking to go beyond their local markets to become a one-stop shop for companies looking to make investments in Central America.

Arias & Muñoz

"Arias & Muñoz are a true Central American firm, and I believe they are building a legitimate regional practice." That's how one competitor described the pan-regional firm; indeed, the firm wants to become a regional power, expanding into the five jurisdictions of Central America. Arias & Muñoz also received praise for its modern corporate structure, and has reached the top tier despite its relatively recent establishment.

One example of the firm's abilities came with its lead in two transactions for international brewer SABMiller. The first involved the sale of SABMiller's Pepsi bottling operations in Costa Rica to local company Cerveceria Costa Rica; the second was for the sale of SABMiller's 42.5% stake in the Reserva Conchal real estate and hotel development. The combined value of the deals was \$116 million.

Coming off the strength of that deal, the firm wanted to demonstrate its regional capabilities. It was able to do so when it advised Spanish food company Ebro Puleva on the sale of its Costa Rican holdings, Compañía de Galletas Pozuelo, to Colombian food company Nacional de Chocolates. Arias & Muñoz was able to coordinate the \$117 million sale in the region, since the deal granted the Colombian firm access to Pozuelo's operations across Central America.

The acquisition of a 49.9% interest in telecoms company Amnet's holdings – by Central American Capital Group – also helped showcase Arias & Muñoz's growing prowess as a regional firm. All five of the firm's offices were called into the deal. Also, besides the obvious transactional aspect of the deal, there were financing arrangements that required the firm's assistance to make it possible.

The Costa Rican office enjoyed a net gain of seven attorneys last year, but founding partners José Antonio Muñoz and Pedro Muñoz continue to be involved in the firm's largest transactions. Vicente Lines and Carolina Flores have also been singled out for their work by colleagues in firms around the country.

Leading lawyers

Carolina Flores
Vicente Lines
José Antonio Muñoz
Pedro Muñoz

Facio & Cañas

Facio & Cañas is such a force within Costa Rica that one competitor said: "They are the strongest by far, and have been able to transition to the next generation; they are the McDonald's of Costa Rican firms."

The comparison is appropriate since the firm's client list includes not only McDonald's, but also one of the few multinational companies with an even greater brand name – Coca-Cola. Other top companies using Facio & Cañas in Costa Rica include software maker Oracle, and investment bank JPMorgan.

The trend of foreign investments into the local tourism and real estate development sectors is best demonstrated by the purchase of land in the northwest part of the country by beach hotel operators Riu. The Spanish company is planning to use this development – worth some \$20 million – to attract European and American clients to Costa Rica.

Another transaction with strategic implications for the firm's client was Nacional de Chocolates' acquisition of Pozuelo, the region's largest cookie maker. Facio & Cañas represented the Colombian company Nacional in the \$117 million takeover, allowing Nacional access to all of Pozuelo's operations across Central America.

One of the challenges the law firm faces is the emergence of other regional firms in Central America. As the largest Costa Rican firm, Facio & Cañas has the most to lose; on the other hand, its size may enable it to make changes needed to address new competitors. The challenge will fall to younger partners like Mauricio Salas and Tomás Guardia, who have been singled out by rivals as those who may help lead Facio & Cañas into the future.

Leading lawyers

Victor Garita
Roberto Leiva
Carlos Valverde

Zürcher Odio & Raven

The consensus within the Costa Rican legal community is that the merger that resulted in Zürcher Odio & Raven has been a success. One rival said: "I'm not sure how well they have managed the integration, but who cares? They do good business, have excellent clients, and are a good team; the merger was a win-win for them." Another said he believed that the firm may soon become the largest in Costa Rica.

The experience of Harry Zürcher Jr has been coupled with the energy of younger talents Claudio Donato and Alberto Raven to produce a firm good enough to receive a top-tier ranking.

Certainly, the firm's client list covers a broad range of the world's most recognized multinationals in various industries. The financial firms are there of course – Banco Bilbao, Vizcaya & Argentaria, Citibank, Merrill Lynch – but also the likes of IBM, Siemens, automaker Hyundai, chemical manufacturers DuPont, and pharmaceutical firms like GlaxoSmithKline and Procter & Gamble.

Leading lawyers

Claudio Donato
Alberto Raven
Harry Zürcher

BLP Abogados

BLP Abogados continues to impress, with a reputation among both peers and clients that belies the firm's relative youth. One rival praised the firm and its leading partners: "Luis Manuel Castor and David Gutiérrez really stood out last year. They have young, first-rate professionals with the right attitude; I can't wait to see how they look in five years." Certainly the firm's client list continues to grow and impress: it has advised American Airlines, ABN Amro and UPS over the years.

When Banco Interfin was purchased by Scotiabank last year, BLP represented the local bank in the \$293.5 million transaction. The deal enabled the firm to demonstrate its ability to handle cross-border work, and as a result it was offered the opportunity to work on some of the Canadian bank's legal issues. Banking continues to be a hotbed of corporate activity, so being able to include Scotiabank as a client could provide BLP with some leverage in the near future.

And international companies already turn to the firm for advice. Brazil-based Amanco underwent a restructuring in order to prepare for a sale to Mexichem, the Mexican chemical holding group. The Latin American conglomerate turned to BLP for counsel for its Costa Rican needs. BLP lawyers not only handled Amanco's general corporate work, they were also able to assist in the company's matters regarding intellectual property, real estate and employment. They also coordinated efforts across Central America with some of the region's other leading firms.

BLP has also assisted in the creation of innovative products. The Overseas Private Investment Corporation (Opic), an American government agency, hired the firm to place a \$30 million loan with Banco Lafise. The proceeds of this loan were used to create the first fixed-fee mortgage in Central America. Considering the increasing emphasis on consumer lending products in Costa Rica, this is a significant achievement.

The firm is well prepared for all this activity, adding seven new attorneys to help keep pace with the demands of its clients. The market consensus is that BLP deserves respect for its accomplishments; with a little more experience, many believe that the firm will move into the top tier. After all, it was labelled by another competitor as "very young, very dynamic and very driven".

Leading lawyers

Luis Manuel Castro
David Gutiérrez

Consortium – Laclé & Gutiérrez

Laclé & Gutiérrez, the Costa Rican member of the Central American legal organization Consortium, garners respect as an eminent law firm for banking and financial matters. The firm has a client list that includes financial powers Scotiabank, Citibank and Fiserv.

The amount of activity in the banking sector has helped the firm remain very active. One rival said: "Consortium must have had a great year – they were the attorneys for Scotiabank when it acquired Banco Interfin." Indeed the \$293.5 million buyout was the deal of the year in Costa Rica, and has left Consortium in a powerful position for future transactions.

The firm is also working with Citibank as it moves into the consumer credit market, signalled by its acquisition of Banco Uno. This opens up a whole new avenue of potential targets for Citibank – smaller banks that have specialized in consumer lending or issuing credit cards. Consortium, as the bank's counsel, will again be in a position to get involved in these deals.

Consortium called on its strength in the international markets on behalf of a client in November 2006. The firm advised the majority shareholders of Durman Esquivel in a share purchase agreement with Belgian company Aliaxis. The \$200 million sale resulted in a joint venture between Aliaxis and the Costa Rican construction company, Aliaxis Latinoamerica.

Like other Costa Rican firms, Consortium is focusing increasingly on real estate. The firm is representing several groups investing in real-estate development projects. Rolando Laclé leads a five-member group which advises on these multi-million dollar investments into projects undertaken by hotel operators like St Regis, Starwood Hotels, and others looking to take advantage of the resort development boom.

That's just the transactional side of the real estate deals. The projects also require financing, and Consortium represents financial clients like Citibank and Scotiabank in under-

writing tens of millions of dollars of loans that give life to the projects.

The firm also represented Hydro Québec when the Canadian firm divested its 50% stake in the Rio Lajas hydroelectric plant. The \$5 million deal enabled Hydro Québec to effectively end its participation in the joint venture.

Leading lawyers

David Arturo Campos
Rolando Laclé Zúñiga

Aguilar Castillo Love

"I value Aguilar Castillo Love for their accuracy and their knowledge of the local markets," said a satisfied client, "and I would use them all across Central America. I like them best." Indeed, the firm is looking to move beyond the Costa Rican market, having expanded into all five countries in the region, as well as opening a new office in Panama.

A client list that includes blue-chip firms such as Hewlett-Packard, Tyco, Whirlpool and PPC Industries, as well as handling local legal matters for General Electric, points to Aguilar Castillo Love's growing reputation with multinational clients. General corporate work has kept the firm busy.

When Hewlett-Packard expanded its services across Costa Rica, making it the largest private employer in the country, Aguilar Castillo Love acted as the computer maker's external counsel.

Competitors have also noticed the firm's regional efforts. One rival said: "Their new branding efforts as a Central American network have given them more visibility."

Leading lawyers

John Aguilar Osbourne
John Aguilar Quesada

Batalla & Asociados

Batalla & Asociados' strength lies in its work with private-equity firms, from which it is able to derive the bulk of its business. This helps Batalla differentiate itself from the competition, particularly since private-equity funds have been quite active recently.

One of its most successful deals in the private-equity sector involved the creation of Caseif Corporation II on behalf of Latin American Financial Services Investment Management. This \$35 million fund is intended to invest in small- and medium-sized businesses throughout Central America, as well as Panama and the Dominican Republic. Banks moving into the country will eventually look beyond the larger corporations, so being innovative with the smaller company financings is a smart strategic move.

While the transactional work is not particularly voluminous, the firm's work does demonstrate a knack for getting involved with Costa Rica's trends. Real estate and resort development is the latest destination of a lot of investor dollars. Batalla advised Lafise Global Solutions for a \$15 million syndicated loan to Desarrollos Naturales de Costa Rica, a resort development group. The deal was derived from its private-equity relationship with Lafise.

While the firm is relatively small, it garners respect. Competitors characterize the firm as comprising "good lawyers" who are "very high quality professionals".

Leading lawyers

Alejandro Batalla
Rodrigo Zelaya

Other notable firms

Well-respected partner Alonso Arroyo leads **KPMG Abogados**, a firm recognized by its rivals as an excellent tax and advisory firm. Indeed, the firm advised a Chilean company through the process to win concessions to manage tugboat services, an investment worth \$12 million. Another client was able to land the exclusive rights to conduct vehicle inspections and emissions testing; the 10-year renewable contract required a \$24 million investment.