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The Mergers & Acquisitions Review - Edition 12

Argentina

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I OVERVIEW OF M&A ACTIVITY

Since Mauricio Macri took office in December 2015, with the clear intent of shifting policy towards a pro-business model, investors have shown a renewed interest for opportunities in Argentina.

While the country still needs to go through some critical and long-term structural reforms, the current government is encouraging investment in several sectors, including technology, agribusiness, energy and infrastructure. Within this context, the Argentine economy still benefits from reasonable, well-priced commodities (in particular, agricultural commodities), an educated workforce and a strong entrepreneurial community.

Thus, it is expected that the rise in M&A activity evidenced since December 2015 will keep growing during the next few years, albeit subject to the ups and downs typically observed in emerging markets.

II GENERAL INTRODUCTION TO THE LEGAL FRAMEWORK FOR M&A

The Argentine capital market is relatively small, lacks sufficient depth, has limited liquidity and is subject to regulations that are just now in the process of being modernised to meet international standards. Further, most Argentine public companies generally have a minority portion of their capital floating in the capital markets (between 10 and 30 per cent). Accordingly, public M&A transactions in Argentina are not frequent.

As a result of the foregoing, most of the M&A activity is done through private deals. These may involve shares, assets or a combination thereof. Share deals are preferred to asset deals.

Share deals are undertaken through stock purchase agreements that generally follow international standards for private transactions. These agreements can be subject to foreign law and jurisdiction (including foreign arbitration tribunals). This is generally the case in transactions for high-end Argentine companies. However, there are some aspects that will necessarily depend on and be governed by Argentine laws (e.g., matters relating to the consummation of transactions, certain matters covered by local securities regulations, labour laws, regulatory requirements, etc.).

Assets deals (such as the bulk transfer of assets) are less common in Argentina (1) for tax reasons (as further detailed below), which, in general, make such transfers expensive as the transfer of each asset is subject to a different set of taxes, and (2) because of timing concerns.

Public M&A transactions that involve the acquisition of a controlling stake may require the acquirer to launch a tender offer to all the minority shareholders in the target company. A mandatory tender offer is not required when the acquisition of a 'significant ownership' does not entail acquiring the control of a company (i.e., more than 50 per cent of the voting securities or *de facto* control) or when a change of control occurs as a result of a merger or a spin-off. The tender offer shall contemplate a 'fair value', which is a term currently being redefined by new regulations.

On a separate note, corporate foreign shareholders must register at the Public Registry of Commerce to be able to hold shares of a company incorporated in Argentina. A foreign shareholder must submit certain corporate and accounting information to obtain registration (it must also submit certain other documents every year to maintain the registration). Basically, a foreign shareholder is required to provide evidence that – either directly or indirectly – it owns substantial assets outside Argentina. Offshore companies may be restricted, and companies incorporated in 'tax havens' are not accepted except under certain limited circumstances. The new Capital

Markets Law has introduced a significant change in this regard by eliminating the registration requirement for foreign shareholders, stipulated in Section 123 of the General Business Organizations Act, when the target company is listed on the stock market.

III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT

There have been no major amendments in corporate and takeover law in recent years, other than as described above.

Certain amendments introduced by the Macri administration to the foreign exchange regime have been critical to the development of the M&A market, in particular the elimination of foreign exchange restrictions to acquire foreign currency and for the transfer of proceeds outside Argentina (including dividends or other profits).

Congress has approved a law to eliminate the 10 per cent tax on dividends imposed pursuant to Law No. 26,893.

Finally, Congress has approved a new public–private partnership (PPP) law. This regime seeks to replace the existing regulatory frameworks, which failed because of technical defects and the critical legal, institutional and economic context affecting Argentina during the past few years. The new law is ambitious and includes various protections in favour of the private sector (contractors and lenders) to effectively foster the development of these associative schemes and generate massive infrastructure investments.

IV FOREIGN INVOLVEMENT IN M&A TRANSACTIONS

As already mentioned, up to December 2015, foreign investment in Argentina decreased sharply as a result of a high level of state intervention in the economy, coupled with a shortage of foreign exchange, which resulted in the former (Kirchner) government freezing all outflow of dollars from Argentina. As a result, companies were not allowed to transfer monies abroad (such as in the form of dividends, royalties or payments for services) and thus foreign investment was drastically reduced.

In this context, most M&A activity involving foreign investors was related to the exit of foreign investors from Argentine assets because of the economic difficulties or as a result of multinationals leaving the region.

Following the election of a more pro-business government in December 2015, foreign investor appetite has increased and we are now seeing a renewed interest in Argentina. While the arrival of foreign investments is still moderate, there is a clear increase in the volume of M&A activity and the size of transactions.

Local and foreign hedge and private equity (PE) funds are particularly active and have closed transactions in the last three years in different sectors: energy (including oil and gas and renewable energy), agribusiness, infrastructure and real estate.

There are no specific required approvals for foreign investments either through PE funds or other types of foreign investments (other than antitrust approval, if applicable). However, depending on the type of portfolio company, activity or industry, as a general rule, certain investments may be subject to prior (or, in some cases, subsequent) approval by different regulatory agencies.

In some regulated industries, such as financial services, insurance, telecommunications, aviation, oil and gas, mining, utilities, companies and utilities, the approval of the applicable regulatory authority is necessary to transfer either the control of, or a relevant portion of the shares of, a company operating in those industries. Investments in real estate (rural lands or land adjacent to country borders) may in certain cases require regulatory approval, and restrictions may apply for foreign entities or individuals.

These processes generally involve the filing of detailed information about the acquirer company, and the various formalities (e.g., translations, legalisations, specific forms) will depend on the type of agency. The timing will also depend on the regulatory agency involved in the process (typically, this may take more than three months to complete).

V SIGNIFICANT TRANSACTIONS, KEY TRENDS AND HOT INDUSTRIES

As already discussed, between 2003 and 2015 (under the Kirchner administration), M&A activity was extremely modest, both in terms of the number of deals and deal volumes, because of limited foreign direct investment (inbound). In contrast, during the same time period, many other countries in the region (in particular Brazil, Mexico, Colombia, Peru and Chile) experienced an increase in foreign direct investment and a resulting increase in M&A activity.

During those years, the M&A market in Argentina was marked by less sophisticated transactions, and deal amounts were far below the average in the region. Only a few transactions have come close to, or crossed, the US$1 billion barrier (*YPF*, *Telecom Argentina*, *Apache*). Instead, most deals closed at a price below US$100 million.

To restore confidence in the (local and international) business community and attract investments, the new Macri administration quickly addressed some of the most urgent economic and legal issues the Kirchner administration had either created or failed to address. Before completing six months in office, Macri, *inter alia*, ended more than 12 years of legal dispute with the holders of Argentine sovereign debt in default, put Argentina back into international capital markets, eliminated taxes on certain exports and eliminated several foreign exchange restrictions (including on the transfer of dividends to foreign parent companies). While it is expected that the deal flow in

Argentina will increase significantly in the coming years, there is already a clear renewed interest in Argentine assets, and we have seen steady growth in the number of deals closed.

In our experience, there is an increased appetite for renewable energy (incentivised by a new special law); PE funds have already closed several deals in this sector. Additionally, several players have compromised investments in the renewable energy sector for more than US$6 billion following a series of auctions conducted by the government.

The recovery in the oil prices should also trigger renewed interest in oil and gas assets (including the shale oil and shale gas projects in Vaca Muerta (see also Section X)). Recently, for example, ExxonMobil and Qatar Petroleum signed a deal for a record investment in Vaca Muerta. International trader Trafigura has also completed a couple of deals to start its downstream operation in Argentina (including in association with its affiliate, Puma Energy).

Further, the offshore bidding round being organised by the government to award exploration permits over offshore blocks is expected to generate substantial foreign investment. In this regard, the bidding procedure established under the Hydrocarbons Law is currently in a preliminary phase. Blocks will be awarded in the Austral, West Malvinas and the northern portion of the Argentina Basin, covering around 200,000 square kilometres.

The agribusiness sector also offers opportunities, and commodities prices have been recovering well in the past few years. This sector is critical to the Argentine economy, as it will trigger a cascade effect on the industrial and services sectors (in which deal volume remains modest).

The aforementioned new PPP law is also expected to foster investments in infrastructure.

VI FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS

Acquisition financing originated in Argentina is very limited and costly. As a result, most foreign investors (including PE funds operating in Argentina) usually obtain their funding from foreign investors, including a wide variety of foreign institutional investors, pension funds, banks, hedge funds, multilateral institutions and individuals. Some PE funds incorporated abroad but managed by Argentine managers obtain funding from local family offices, private individuals and some investment companies. Local banks, insurance companies and government agencies do not normally invest in PE funds, and there are currently no regulations to promote or provide incentives for this.

Generally speaking, local portfolio companies are funded mainly through capital contributions. Therefore, debt obtained from foreign sources is used to a lesser

degree, and local financing is available, although it may not cover all the financial needs of the portfolio company.

Interest under a debt has the advantage of being tax deductible. The Argentine Central Bank regulations contemplate that, under certain circumstances, some loans may need to be reported to the Bank. Currently, there are no foreign exchange regulations applicable to lending transactions or otherwise.

VII EMPLOYMENT LAW

In the case of the assignment of a business, all liabilities in relation to employees will be transferred to the purchaser. If an employee is seriously affected by the assignment of a business, it is possible for that employee to consider him or herself in a position of constructive dismissal. The same applies in the case of the leasing or temporary assignment of a business.

The transferor and transferee (on any title) will be jointly and severally liable for the obligations deriving from the labour relationships that exist at the time of the transfer or assignment of a business. The transfer of personnel (without the establishment) shall only be carried out with the written consent of the affected employees.

The main effect of the assignment of a business is that the former employer is replaced by the purchaser or successor. It is not necessary that employees consent to the transfer.

A change of employer has consequences with respect to all the employment relationships that are in force, not only to all current labour relationships but also to those in which the obligation to effectively render services has been temporarily suspended (e.g., if personnel are on holiday or on sick leave).

A purchaser or successor may not oppose an employee whose services were suspended for any reason at the moment of the assignment of a business, even if the purchaser or successor has not been informed by the previous employer of the suspension.

The labour conditions currently in force regarding the assignment of a business, such as the office location, working hours and salaries, should be maintained by the purchaser or successor without prejudice to the legitimate right of the employer to modify labour conditions in the future within the limits established by the applicable labour law.

Pursuant to the mandatory case law, a purchaser or successor of a business is liable for the transferor's obligations that derive from employment relationships that were terminated before the transfer. This implies that the purchaser or successor shall even be liable for the labour credits of previous employees who have worked for the transferor within the statute of limitations period, which for labour credits is two years.

Under the applicable law, an employee may consider him or herself to be in a situation of constructive dismissal if the assignment of a business causes serious damage to him or her – for example, if he or she was working for an economically sound company and, as a result of the assignment of the business, he or she has to start working for a markedly insolvent company. The sole fact of the assignment of a business to a purchaser or successor does not mean that the employee can automatically consider that he or she is subject to constructive dismissal.

In the case of the purchase of the stock of a corporation, there would be no assignment of a business, since the employer (the corporation) would remain the same no matter who the shareholders are.

According to the majority of local legal scholars, the transferor of a business does not assume any liability for the labour obligations of the purchaser or successor after the date of transfer. All liabilities with respect to employees shall be assigned to the purchaser or successor in interest.

VIII TAX LAW

Capital contributions are not subject to any tax in Argentina as long as the company receiving the contribution is located in the City of Buenos Aires or a province that does not apply stamp tax (which some provinces do).

Holdings of shares issued by Argentine companies when the holder is a foreign resident are subject to a 0.25 per cent personal assets tax on their percentage net equity on 31 December every year. The Argentine company is liable for the tax, but it has a claim against the foreign shareholder for the amounts paid. Under recent National Supreme Court case law, branches of foreign companies are not subject to this tax.

Dividends distributed by Argentine companies to their foreign shareholders are subject to withholding tax depending on when the distributing company earned the profits out of which the dividends are paid. For fiscal years beginning on or before 31 December 2017, there is no withholding tax (provided the profits have been taxed at company level). For fiscal years beginning on or after 1 January 2018 and until 31 December 2019, dividends are subject to a 7 per cent withholding tax. For fiscal years beginning on or after 1 January 2020, dividends are subject to a 13 per cent withholding tax.

In a share deal, capital gains arising from the transfer of shares issued by an Argentine company (including redemption) are subject to a 15 per cent income tax when made by a foreign resident. In the case of a non-resident entity, the transferor may opt to pay a 13.5 per cent tax on the transfer price. If both the transferor and the transferee are non-resident entities, the local representative of the transferor is liable to pay the tax. Stamp tax on the share transfer agreement may be avoided through a letter offer agreement in most provinces.

Capital gains tax also applies to transfers of shares of entities above the direct shareholder, but only when the transferred shares were acquired on or after 1 January 2018.

Transfers of assets as a going concern are subject to various taxes depending on the asset. The transfer of all sorts of assets is subject to income tax on any capital gain. For fiscal years beginning between 1 January 2018 and 31 December 2019, the income tax rate will be 30 per cent. For fiscal years beginning on or after 1 January 2020, the income tax rate will be 25 per cent. The transfer of real estate is subject to stamp tax at a rate of around 4 per cent, depending on the province where the real estate is located; the tax is customarily shared (half by the seller, half by the purchaser). The transfer of fixed movable assets is subject to VAT at a rate of 21 per cent (10.5 per cent on machinery and similar equipment). The transfer of inventory is subject to VAT at a rate of 21 per cent (10.5 per cent on some agricultural products) and to gross turnover tax (at a rate of around 3 per cent, but this depends on the province to which the tax basis is allocated). In all cases, the agreement is subject to stamp tax, but this may be avoided through a letter offer (with the exception of transfers of real estate and automobiles). As already stated, the tax is customarily shared by the seller and purchaser.

IX COMPETITION LAW

A new antitrust law was passed by Congress in May 2018.

An important change introduced by this new law lies in the timing for auditing mergers and acquisitions. The old regime established an *ex post* control (i.e., transactions where reviewed after closing), whereas the new law establishes an *ex ante* control (i.e., transactions are now reviewed prior to closing).

The Antitrust Law requires that transactions in which the 'aggregate business volume' of all companies involved therein in Argentina is higher than 100 million mobile units (which is roughly equivalent to US$80 million (as at May 2018)) be approved by the Antitrust Authority before closing. The 'aggregate business volume' means the amounts resulting from the commercial activity and direct subsidies received by the companies involved in the transaction during the last financial year, corresponding to their ordinary business, and calculated on an after-tax basis.

Authorisation will have to be obtained from the Antitrust Authority for the transaction to enter into force between the parties and to be effective with regard to third parties. Failure to request and obtain authorisation, or if authorisation is not granted by the Antitrust Authority, shall render the transaction void, without prejudice to any sanction that may be applicable in the case of rejection.

The Antitrust Authority shall make the request for approval public, so that interested parties can submit objections. Within 120 days of the request being made public, the Antitrust Authority will have to decide whether to (1) approve the transaction, (2) approve the transaction subject to certain conditions or (3) reject the transaction.

Failure to issue a decision within 120 days shall be regarded as an unconditional authorisation by the Authority.

Transactions closed prior to obtaining the Antitrust Authority's authorisation will render the companies involved subject to fines, regardless of the Authority's decision regarding the transaction. If the Authority finds that it was a prohibited transaction under the Antitrust Law, the companies will have to divest the acquired assets. The transactions subject to review and approval are:

a. mergers;
b. the bulk transfer of assets, including transfers of ongoing concerns;
c. the purchase or acquisition of any interest in stock, equity participations or debt instruments convertible into stock, or equity participations that provide the right to influence the decisions of the issuer thereof, when, in either case, the purchaser of the same obtains through the acquisition of those securities or equity interests, the 'control' of or a 'substantial influence' on the issuer; and
d. other transactions that entail a *de facto* transfer or a dominant influence upon the decisions of the company in question.

The law does not contain any specific definition of 'substantial influence'. However, recent rulings by the Antitrust Commission have concluded that the right to appoint a certain number of directors, or the right to appoint key officers or the existence of supermajorities are relevant factors for deciding in a particular case whether the buyer of a non-controlling interest in a company nevertheless acquires a 'substantial influence' therein.

During the first year of the Antitrust Authority being established, notice of any of the transactions subject to prior review and approval may be filed with the Antitrust Authority either prior to their consummation or within 'one week' of closing.

However, until the Antitrust Authority is created, and the aforementioned one-year period elapses, the old antitrust regime will continue to apply.

Companies involved in a potential transaction may submit their situation to the advisory opinion of the Antitrust Authority, which will determine whether the proposed transaction should be submitted for authorisation.

Significant changes to the previous regime are being introduced. Even though transactions were only considered valid between parties and with regard to third parties upon review and approval under the old antitrust regime (a requirement that continues under the new regime), approval could be obtained after closing. The only real obligation of the parties was to notify the authorities either before closing or within a week of closing. Failure to notify was penalised with fines.

Although failure to obtain the required prior approval and denial of the approval after closing did not entail the imposition of penalties insofar as the filing had been made within the specified deadlines, by consummating the transaction without approval, the

parties assumed the risk that approval could be denied or conditional, thus resulting in a need to divest the acquired assets totally or partially.

X OUTLOOK

As has been outlined, the change of administration in December 2015 triggered a change in expectations that should translate into the renewed interest of foreign investors in Argentina.

The government has clearly indicated that one of its main goals is to attract foreign investments. This goal requires some pending structural changes, including those aimed at reducing the fiscal deficit and high inflation rates, reducing labour costs and improving quality standards within government institutions.

Infrastructure and energy are both in need of investment and, to that effect, the government has launched a public auction to construct projects to provide more than 1,000 megavolts of energy from renewable sources (mainly solar and wind). Additionally, Vaca Muerta (a rock formation in the province of Neuquén where a large oil and natural gas discovery was made in 2010 – it is considered to be one of the largest shale fields in the world) has attracted a lot of attention from foreign investors, which have positioned themselves in the area and are waiting for pricing conditions to develop.

Footnotes

[1] Fernando S Zoppi is a fouding partner of Martínez de Hoz & Rueda.