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# COLOMBIA

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## **TRENDS AND DEVELOPMENTS:**

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Contributed by Gómez-Pinzón

The 'Trends & Developments' sections give an overview of current trends and developments in local legal markets. Leading lawyers analyse particular trends or provide a broader discussion of key developments in the jurisdiction.

## Trends and Developments

Contributed by Gómez-Pinzón

**Gómez-Pinzón** (GPZ) has one of the largest corporate/M&A practice groups in Colombia and is renowned for providing high-quality advice on the market's biggest, most sophisticated and innovative corporate/M&A transactions, including multi-jurisdictional and cross-border deals, representing not only strategic buyers but also private equity funds. The firm has outstanding experience of representing sellers and buy-

ers in M&A transactions, with public and private targets, and in negotiated and hostile acquisitions. GPZ also handles the complete range of corporate work, from day-to-day matters, mergers, spin-offs, incorporations and liquidations, to drafting contracts, structuring complex corporate reorganisations, foreign exchange matters and rendering advice relating to the sensitive decision-making of boards of directors.

### Authors



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**Andrés Hoyos** is the partner head of the corporate/M&A department and a member of the steering committee, with more than 26 years' professional experience. His practice focuses on M&A, private equity, joint ventures, financing transactions and securities. Andrés is admitted to the practice of law in the State of New York and in the Republic of Colombia, and is a member of the Association of the Bar of the City of New York and the International Bar Association. Andrés received a diploma in capital markets from the Universidad del Rosario and has an LLM in comparative law from the University of Miami.

### Introduction

Colombian infrastructure has lagged behind other Latin American countries for several years now. The World Economic Forum rates Colombia's infrastructure 84th out of 138 countries, while neighbouring countries such as Panama, Chile and Ecuador are ranked 36th, 44th and 71st, respectively. This situation has become a threat to Colombia's competitiveness and sustainable growth, considering the country's areas of production are poorly connected to cit-

ies, ports and airports. As a result, over the past eight years, the Colombian government has put considerable efforts and resources into improving Colombia's connectivity through the fourth-generation road infrastructure programme ("4G Concessions Program"). The goal is to facilitate international trade, regional development and centralised government through an expansion of the country's transportation network.

# COLOMBIA TRENDS AND DEVELOPMENTS

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## New Legal Framework and Developments

In 2011, the government created the National Infrastructure Agency (ANI), a state national agency ascribed to the Ministry of Transportation, for purposes of structuring the 4G Concessions Program as well as any other infrastructure concessions (ie, ports, airports, and railways) and public-private partnerships (“PPP”). ANI was created with better administrative capacity, qualified personnel and technical expertise to ensure more transparency in the public procurement of the infrastructure concession programme. The government also promoted a more stable legal framework by dealing with some of the issues that had been an obstacle to infrastructure development in Colombia. For example, Law 1682 of 2013 (Transport Infrastructure) was enacted to provide guidelines in terms of infrastructure requirements, dispute resolution matters, land acquisition, environmental licences, and communities, among other things. This law has brought some important tools to facilitate: (i) the proceedings regarding environmental permits and licences; (ii) the negotiations to acquire the land and accelerate the expropriation processes required for infrastructure projects; and (iii) the negotiations to remove and/or relocate the existing facilities (wires, pipelines, etc). In addition, Law 1753 of 2015 amended some Articles of Law 1508 of 2012, in order to enhance the PPP development. As an instance, the concept of limited liability was introduced in Law 1508 to limit the liability of the sponsors with respect to the obligations of the project company according to the rules applicable to the latter. This was a very important change as, under the rules of Law 80 of 1993, many sponsors were held directly liable for the obligations of the concessionaire. Besides, even though under the Colombian PPP model the main risks are allocated on the private party (the investor is the responsible party for the design, construction, operation and maintenance of the productive or social infrastructure given in a concession and its related services), the Colombian government has accepted in some concessions of the 4G Concessions Program to share some important risks, such as environmental, social and land acquisition risks, in order to attract more investors.

Additionally, the entry into force of Law 1882 of 2018 (the new Colombian infrastructure regulation) is an element that can contribute to the rise of infrastructure M&A in 2018. Among other matters, this new regulation sets forth a new rule regarding early termination of public-private partnership (PPP’s) agreements and facilitates the process of land acquisition and allocates on the concessionaires the responsibility of obtaining all the necessary archaeological permits for the development of each project.

In general, we have seen that with the 4G Concessions Program, Colombia is moving away from its classical model of infrastructure development, in which the concessionaire acted as the financier, promoter and constructor. The current

tendency is to have different players with specific responsibilities, which is a healthy change.

These steps helped make infrastructure projects more appealing to both national and foreign investors. With 40 new road concessions representing 8,000 kilometres of roads and 3,500 kilometres of highways, the 4G Concessions Program is the largest programme of its kind in Latin America.

In the context of this regulatory development, the government has structured and carried out the first round of bidding processes for the 4G Concessions Program, where investments are estimated to reach USD17 billion for the first round, and over USD40 billion for future rounds over the next ten years. The first 4G concession to get off the ground was the Pacifico Concession (a highway that will link Antioquia department to the southern region of Colombia), Phases 1-3, which issued the first-ever foreign project bond for a Colombian toll road, and which obtained a four-tranche loan worth USD285 million and a total raised of approximately USD650 million, according to financial media.

## Main Issues and Challenges

Despite the governments’ best efforts, the execution of the 4G Concessions Program has not been easy. Land management, environmental matters and prior consultations to certain communities (“*consulta previa*”) have been the toughest work streams, leading to considerable delays and cost overruns.

For instance, despite clear rules governing the expropriation law process, land acquisition is an issue for infrastructure projects in Colombia, since the property rights of the landowners are difficult to establish in certain regions – the real estate registry is decentralised, incomplete, not standard and outdated. Besides this, the price is problematic to set since there is usually opportunistic behaviour from sellers. Finally, there is an additional issue when the land belongs to an indigenous community, as they may not be subject to an expropriation process.

Environmental licences are delayed because the environmental authorities usually take longer to analyse the information filed by the concessionaire, and in some cases authorisation depends on the finalisation of other processes, such as the prior consultation process with ethnic minorities or the subtraction of forest reserves or lifting of a ban on protected flora species. Prior consultation processes represent a significant challenge as consultation is considered to be a fundamental right of these communities; however, Colombia does not have a specific law regulating the timing and special conditions of this process. Therefore, these processes usually last longer than six months. Although ethnic communities do not have the right to veto a project, the government has a duty to guarantee that the communities are

properly consulted, even if there is no final agreement with them. Another significant challenge related to communities is their identification by the Ministry of Interior. In some cases, the information on the presence of these communities is scarce, leading to litigations initiated by the communities and to suspension of the execution of the projects until the communities are properly consulted.

In addition, the fact that concessionaires must deal with communities that oppose these infrastructure projects has led to uncertainty and concerns from financiers. These issues are handled under the concession purchase agreements in the representations and warranties, as well as in the special indemnities that sellers give to buyer(s). Generally, these risks are covered by the seller up to a reasonable extent, after which the buyer bears the allocation of risk and the financial consequences it may imply.

The importance of these three issues – land acquisition, environmental licences and prior consultations to communities (*consulta previa*) – is not only limited to their consequences under the concession agreement, but also under the financing documents, as they are the main milestones to reach financial closing (ie, disbursement of funds) under the 4G projects in Colombia.

Other risks relate more to the current dynamic of the market of 4G projects in Colombia, where projects are concentrated among few participants, which may imply a high systemic risk. In this sense, the market was particularly attuned to the outcome of the recent Odebrecht corruption scandals (which affected directly the Concession *Ruta del Sol 2*), since there was a concern that the termination of such concession could lead to termination consequences in other 4G concessions, particularly if a forfeiture power (“*caducidad*”) was applied by the government. Fortunately, the market seems to have overcome these concerns, particularly as a result of the mutual agreement between ANI and Episol (concessionaire-owned 70% by Odebrecht and 30% by Corficolombiana) to terminate the concession agreement. Besides, the 4G Concessions Program is structured in such a way that the government honours the payment of the works already performed by the concessionaire (once a “functional unit” has been completed) through a trust set up for each 4G project, which ultimately secures the payment to the banks of their financial obligations, as happened in the case of Concession *Ruta del Sol 2*.

Finally, another difficulty on 4G projects is related to their financing. Local banks have not been able to cope with the financing needs of 4G concessions due to sector-concentration risks in the banking system and its corresponding regulatory constraints. As a result, financial closings for ongoing 4G projects have been delayed. Large portfolios of projects

are becoming available but they require financing to complete development or continue operations.

### **M&A Opportunities**

The high equity requirements of these 4G concessions, and the interest of foreign investors in developing markets with a legal and economic stable system, are the main reasons why M&A opportunities in this area have arisen, as current participants involved in such concessions do not have all the equity required, and their current credit exposure with banks is reaching the allowed limits. In that sense, some sponsors are looking to cash in part of their interests in some of their projects to use such resources in the remaining projects. This has become an opportunity for institutional players and bigger financial and strategic investors that are willing to enter the local market. In fact, we have seen increasing M&A activity within previously awarded 4G concessions, which are subject to ANI approvals. Besides, projects that have closed on their financing and begun the construction phase are interested in engaging new partners. Non-traditional project finance participants, such as private equity and hedge funds looking for higher yielding investments, are increasingly active in this space. Multilateral agencies may bring development funds whereas other strategic investors, such as international construction companies, are not only interested in participating as sponsors, but also as contractors under the EPC agreements.

Some of the M&A activities that we have recently seen in concession road projects are the following:

- InfraRed Capital Partners purchased a 50% stake in a 4G highway project east of Bogotá (*Perimetral de Oriente*) from Israeli construction company Shikun & Binui for an undisclosed amount;
- Ashmore purchased a toll road concessionaire (*Concesión Santa Marta-Paraguachón*) for USD42 million from constructors Valorcon, Odinsa, Construcciones El Cóndor and Conca;
- Conconcreto sold to Vinci Highways 50% of its participation interest in the Concession Bogotá-Girardot (*Tercer Carril*);
- Local players Castro Therassi and Colpatria acquired a participation interest in the Concession *Cartagena-Barranquilla*;
- Private equity fund CFC-SK acquired a 10% stake in the Concession Pacifico Phase 1.
- Corficolombiana acquired from Spanish-based construction company Iridium Concesiones de Infraestructuras its participations in the 4G projects Mulaló-Loboguerrero and Conexión Pacífico 1, both in the project companies and in the construction consortiums.

In our case, we are currently representing both financial and strategic investors in the potential acquisition of substan-

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tial stakes in eight different concession road projects, which leads us to believe that there will be a lot of movement in M&A infrastructure deals in the following months.

Finally, a new round of concession contracts is expected. Projects will expand into other areas of infrastructure, including river ports and the construction of buildings and facilities for different local authorities. The Colombian government is also working on concession projects and PPPs such as the re-establishment and development of the Colombian railway system, the refurbishment of Bogotá and Barranquilla airports and the so-called “social infrastructure projects,” which include hospitals, schools and prisons. Considering the above, we expect a boom in M&A infrastructure deals in the following months and years to come.

### Key Issues on 4G projects’ M&A deals

It is worth mentioning that local market knowledge is essential when it comes to infrastructure M&A deals in Colombia. A thorough understanding of the Colombian legal system (in particular, the Infrastructure Law), its financial institutions and a minimum grasp of the governmental authorities’ mindset is key for a foreign investor to achieve a successful deal. From our experience, any potential investor participating in infrastructure M&A deals in Colombia should consider the following challenges that have arisen in other transactions of this kind:

- *Due diligence (land, environmental and communities’ issues).* A thorough due diligence processes, focusing on issues related to (i) land management, (ii) environmental licences and (iii) prior consultations to communities (*consulta previa*) is required. (See section 3, below, for a more detailed description on these issues.)
- *Authorisation by the ANI.* Concession agreements establish that the 4G “leaders” of a concession are not able to assign their participation interest in the concessionaire if they don’t continue to hold at least 25% of the concessionaire’s stake. Some of the contracts also state that any partner that attested financial standing may not assign their participation rights. Such restrictions usually apply during the pre-operative stage and the first year of O&M, unless ANI previously approves the transfer. After the first year of O&M has gone by and until termination of the Concession Agreement, leaders and non-leader stakeholders that certified financial capacity must remain stakeholders but no restrictions concerning their participation are imposed. Please note: there is currently a debate to determine whether an indirect sale of the concessionaire could occur under the 4G projects. Change of control provisions are not common in such concession agreements but we expect to see provisions of this nature in 4G agreements to come.
- *Early termination of the concession agreement.* In an event of early termination of the concession agreement, the liquidation of such contracts would include the payment of

certain amounts derived from the application of the early termination formulas included in the concession agreement. The Council of State of Colombia has recognised that, in addition to the events of early termination incorporated within the corresponding concession agreement, the contracting entities have the power to terminate a public contract early using the faculty stated in Article 45.2 of Law 80 of 1993. As per this Article, the legal representative of a contracting entity is entitled to terminate the contract whenever there are evident grounds for absolute nullity – that is, when the agreement: (i) was entered into with a contractor incurring an inability or incompatibility event; (ii) was entered into against an express constitutional or legal prohibition (ie, corruption); or (iii) when the acts that constituted the basis of the contract have been declared null. The event of early termination based on the occurrence of the circumstances described in Article 45.2 of Law 80 was not included in the 4G concession agreements as an early termination event, therefore it is not included as one of the circumstances in which the liquidation formulas apply. As a result, the 4G concession agreements do not recognise any compensation or payment derived from the circumstances mentioned in Article 45.2 of Law 80 of 1993. Future 4G concession agreements will have to address this issue. As an alternative for current projects under such scenarios, a direct agreement could be reached between the parties to apply the same formula to pay the financing of the project. Even though under the Odebrecht corruption scandal the Superintendency of Industry and Commerce requested the termination of the Concession *Ruta del Sol 2* under the grounds of Article 45.2 of Law 80, this concession was finally terminated under a mutual agreement between ANI and Odebrecht, therefore the risk mentioned above disappeared.

- *Step-in rights.* Lenders’ step-in rights are not automatic and their exercise is only possible when concessionaire’s rights of defence and due process have been observed. Furthermore, before lenders’ step-in rights are triggered by the concessionaire’s default or major breach of the concession agreement, a remedy period is to be given to the concessionaire. If the concessionaire fails to cure its breach, then a process to impose penalties must be followed. Please note that step-in rights are provided for default or major breaches of the concessionaire only, therefore it will be very difficult to exercise in the events described in Article 45.2 of Law 80 of 1993 mentioned above, which lead to termination of the contract whenever there are evident grounds for absolute nullity, which means that the lenders will not be able to step in, in the event the contract can be declared null and void by the corresponding judge.
- *Package of transaction documents.* As sponsors are required under the concession agreement, the financing agreements and the insurance policy of the concession agreement to provide some guarantees and collaterals, the negotiation of this M&A agreements should include a complete pack-

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age that covers these different aspects for the investor. In this sense, depending on the stage of the concession agreement and the financing, investors should try to guarantee in the transaction documents their active participation in the negotiation of the EPC, the O&M and the financing agreements. This can be included as a condition precedent under the stock purchase agreement. This issue is especially crucial for financial investors, as in most cases they do not participate in the EPC or O&M agreements and, therefore, it has to confirm that the risks under the concession agreement are transferred to the EPC and O&M contractors as part of the back-to-back principle.