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THE LAWREVIEWS

*Expert Panel 2018*

# The Mergers & Acquisitions Review

***Twelfth Edition***

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This article was first published in August 2018*

**Chapter 14**

DOMINICAN REPUBLIC

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**I. OVERVIEW OF M&A ACTIVITY**

During the past few years, we have seen important M&A taking place. Several cross-border M&A have also had an impact in the Dominican Republic, as discussed further below. In both scenarios, the M&A occurred in different and significant sectors of the economy.

Like the rest of the world, the financial crisis has affected the Dominican economy; however, major foreign investments continue to develop and grow in the Dominican Republic, which are consistent with the recent level of M&A activity in the country.

**II. GENERAL INTRODUCTION TO THE LEGAL FRAMEWORK FOR M&A**

M&A deals occur through a merger by incorporation of a new entity) or absorption of one or more of the companies merged), a share transfer or an asset purchase. Law No. 479-08 of General Companies and Limited Liability Individual Enterprises was enacted in December 2008 and later modified by Law No. 31-11 (the Companies Law).

This statute repealed the provisions effective until the current date of the Commercial Code regarding companies (Articles 18 to 64 inclusive), introduced important legal modifications concerning the incorporation, life and dissolution of companies, and, in addition to the existing corporate vehicles, introduced three new corporate vehicles: limited liability company (SRL), limited liability individual enterprise (EIRL) and simplified company (SAS).

Moreover, Chapter IV of the Companies Law provides a definition for the term ‘merger’ and establishes a process for its fulfilment from a corporate standpoint. It defines a merger as a transfer made by one or more companies of their assets and liabilities, either to an existing company or to a new one, whereby the shareholders of the company that makes the transfer receives shares in the company or companies that receive the assets and liabilities, and, eventually, a liquid amount that cannot exceed one-tenth of the nominal value of the shares.

The merger must be approved by a shareholders’ extraordinary meeting of all the companies involved, and will entail the following consequences: the dissolution without liquidation of the companies that disappear, and the transfer of all their assets and liabilities in the state that they are in on the date of final completion of the transaction to the beneficiary companies. Simultaneously, the shareholders of the disappearing companies become shareholders in the recipient companies. When a new company is incorporated as a result of a merger, its by-laws must be approved by an extraordinary general meeting of all the companies

that will cease to exist, and the new company must confirm and acknowledge those approvals. The companies involved must execute a merger agreement.

Before the approval of the merger, the companies involved in the transaction must appoint one or more commissioners, who must render a written report with the particulars of the merger, and who shall verify that the value attributed to the shares of the participating companies are adequate and that the rate of change is equitable. Additionally, the report must include the estimated value of in-kind contributions and particular advantages, if there are any. The report will be made available to the shareholders prior to the meeting, and must be taken into consideration during the meeting before the approval of the merger.

Commissioners must have a bachelor's degree in accounting, business administration, finance or economics, and at least three years' experience in their profession. There are certain conditions that prohibit individuals from being appointed as commissioners:

- a. conviction for criminal offences or bankruptcy (fraudulent or not) by an irrevocable judgment;
- b. disbarment, by virtue of a judicial or administrative decision, from the practice of commercial activities;
- c. public officers with duties related to the activities of the company;
- d. the founders, in-kind contributors, beneficiaries of particular advantages, directors of the company or its subsidiaries and their relatives up to the fourth degree;
- e. directors (and their spouses) of other companies that own one-tenth of the paid capital of the company in question; and
- f. any individual (or his or her spouse) who directly or indirectly receives a salary or compensation from the company for undertaking permanent activities different from those assigned to the commissioner.

Commissioners may require the delivery of all useful documents related to the merger from all the companies involved, and will provide the necessary confirmation of their content. Likewise, depending on the types of companies involved, the boards of directors of the companies must render a written report on the merger project.

Within 30 days of the execution of the merger agreement, the companies involved in the process must file it along with the meeting minutes that approved the agreement before the corresponding chamber of commerce. Additionally, an extract with the main terms of the merger agreement must be published in a newspaper with national circulation.

In contrast, a shareholders' meeting is not always required when an acquisition is made through an assets purchase; this will depend on the types of assets being purchased and the by-law requirements. If a company is selling all its assets, a shareholders' meeting must approve the sale. Nonetheless, the law and principles that govern the agreement itself will be those of the Civil Code. Notwithstanding this, the parties are free to choose the jurisdiction that will govern the agreement.

Regarding acquisitions made by share transfer, depending on the type of entity that is selling the shares and the provisions of the by-laws, existing shareholders may have the right of first refusal or right of first offer and, in some cases, tag-along rights. The Companies Law governs shared transfers.

Law No. 141-15 on the restructuring and liquidation of companies and merchants (the Restructuring Law) was enacted on 12 August 2015 and came into effect in February 2017. Its Ruling for application was also enacted in February 2017. Under the Restructuring Law, any company or merchant in cessation of payments over a certain period, or if at least one of the other scenarios provided in Article 29 of the Law occurs, the affected party or the debtor can request the restructuring of the company. If the formalities for requesting a restructuring process have been met, a verifier will be appointed who will confirm whether there are grounds for the debtor to undergo a restructuring process. If so, a conciliator will be appointed, and the process should end in a restructuring plan that is approved between the majority (60 per cent or more) of the acknowledged and registered creditors and the debtor. If it is not feasible for the debtor to undergo a restructuring process, the liquidation of the company could be ordered by a court. If this occurs, a liquidator will be appointed and will perform all actions related to the sale of the company as a whole (running business) or the company's assets. Once a restructuring request has been filed at court by the debtor, or the debtor has been notified by the creditor or creditors of a filing at court of a restructuring request, the debtor must inform the court and the verifier, among other actions, of any act that represents a direct or indirect merger of the debtor.

### III. DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT

Regarding takeover provisions, the Companies Law provides that in every company, except limited liability companies (LLCs), any shareholder (individual or legal entity) that achieves a participation of more than 10 per cent of the voting shares must notify the company, via a bailiff's act, within a 15-day period counted from the acquisition of shares that amounted to 10 per cent or higher, indicating the number of shares owned and the votes it has in a shareholders' meeting. LLCs are excluded from this requirement, presumably because the Law specifically provides for their shareholders and the company itself rights of first refusal, whereas in other companies those provisions are only in place if they are included in the company's by-laws. Thus, because of its *intuitu personae* nature, an LLC always knows the intention of its shareholders to transfer shares in advance, and the number of shares being transferred, and can therefore take action on the transaction should it wish to do so.

The Law also provides that a corporation cannot have investments in another company if the latter holds 10 per cent or more of the capital of the former. Likewise, there is a similar provision for any other type of company that has a corporation among its shareholders.

Even though Law No. 249-17 on Securities regulates the stock market and the Companies Law provides certain provisions applicable to corporations whose shares are publicly traded, to date there is not a single company that is publicly traded; thus, the probability of a hostile takeover occurring on a Dominican company is very remote.

#### **IV. FOREIGN INVOLVEMENT IN M&A TRANSACTIONS**

The vast majority of M&A transactions that have occurred in the Dominican Republic have been from foreign investments and from different countries. As a result of the financial crisis, the number of business synergies, mergers and consolidations keep increasing as a way to cope with the difficult economic conditions.

Banking institutions, both local and foreign, have a prominent influence on M&A transactions.

#### **V. SIGNIFICANT TRANSACTIONS, KEY TRENDS AND HOT INDUSTRIES**

The number of M&A has risen during recent years. While there might not be a significant difference in the volume of the transactions taking place, the settlement of transactions and the high-profile entities that have merged or that have been acquired have increased exponentially.

The most relevant mergers and acquisitions during the past few years are as follows:

- a. in 2015:
  - in late 2015, an important French company in the airport management industry obtained all the shares of the local company that runs and operates six international airports in the Dominican Republic. The deal contemplated a transition period that ended in March 2016; and
  - a major Spanish hotel group acquired another hotel chain that has two hotels in the Dominican Republic;
- b. in 2016:
  - a French group acquired the majority (70 per cent) of a fund that owns approximately 130 petrol stations throughout the Dominican Republic from a US parent company;
  - a Japanese company acquired 50 per cent of the shares of a local cigar company. The deal is said to have amounted to around US\$14 million; and
  - an American hotel group acquired a hotel group that had several hotels in the Dominican Republic. The deal was concluded in September 2016;
- c. in 2017:
  - a Spanish hotel group acquired three hotels in the Dominican Republic for approximately US\$100 million. The deal was concluded in December 2017;

- a Japanese company, the leader in the sanitary industry, acquired a local factory in the same market. The deal was announced in November 2017;
  - a Lithuanian airline that owned 65 per cent of the shares of a Dominican airline sold its shares in June 2017; and
  - other M&A deals mainly happened abroad but affected the Dominican Republic: for example, a Dutch–British multinational signed an agreement to acquire the personal care and house cleaning line brands from a Colombian multinational, both of which have a presence in the Dominican Republic; and
- d. to date in 2018:
- the largest Brazilian company in the brewery industry increased its ownership (to 85 per cent) in the main local brewery by acquiring an additional 30 per cent of the shares. The deal is said to have amounted to around US\$926.5 million. The deal was announced at the end of last year and finalised at the beginning of 2018.

## **VI. FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS**

Typically, M&A are financed through loans, which are guaranteed by assets of the buying company, or one or more of its subsidiaries, debt finance or private equity funds.

When financed through loans, several banks are usually involved in the lending. In the case of Dominican banks, solvency ratio restrictions are determined by Monetary and Financial Law No. 183-02, which places certain boundaries on the lending bank with regard to the amount that can be lent to a single entity or economic group. Moreover, while Dominican banks are participants in the financing of different mergers taking place in the Dominican Republic, the main lenders are almost always foreign banks, particularly US banks.

As indicated above, when a bank grants a loan, usually certain assets of either the parent company or one or more of its subsidiaries are given in guarantee. If the assets placed in guarantee are located in the Dominican Republic, depending on the type of assets, there are filings and recording processes to be fulfilled. Typically, tangible assets (such as machinery, equipment, vehicles) are given in chattels without loss of possession, as governed by Law No. 6188 of Agriculture Foment. There are certain formalities and restrictions surrounding chattels without loss of possession; for example, the borrower cannot grant a chattel over assets that have already been pledged unless the previous lender renounces its rights. In addition, the contract must be executed before a justice of the peace or a notary public, and it must be recorded by the justice of the peace of the domicile of the borrower in order to make it opposable to third parties, and in this way safeguard the privilege that the creditor is entitled to with the subscription of this type of contract. Furthermore, if the assets are vehicles, in addition to the chattel without loss of possession recordation, a transfer opposition is recorded before the Tax Office to avoid the transfer of the registration of the vehicles.

When the guarantee is real estate property, it must be recorded before the corresponding title registry of the real estate property, and a 2 per cent lien over the value of the property must be paid to the Tax Office.

Furthermore, local financing institutions typically require that the borrowing company executes a promissory note, which is a form of security that is invested by the prerogatives provided for by Article 545 of the Civil Procedural Code, and it will be considered a title of enforcement, without the need for a court ruling, in the event of the debtor's default. The promissory note has very specific and mandatory rules as to the form of the document, and must be drawn up by a local notary public. Among the requirements of the promissory note are that it must be in Spanish, and be validated and executed by the borrower in the presence of a notary public. Stamp tax and recording fees apply.

Regarding debt finance, since the acquirers are mainly foreign, the bonds and other forms of securities are rarely placed in the Dominican Republic. However, if a public offer is made in the Dominican Republic, then Dominican law, as per the terms of Securities Law No. Law 249-17, will govern it.

Private equity as a financing method, from both local and foreign sources, is growing steadily.

Finally, considering how volatile the local currency is, foreign currency, mainly the US dollar, is used for any financing options.

## **VII. EMPLOYMENT LAW**

Employment is governed by the Labour Code, which was enacted on 29 May 1992.

The relevant matters to consider in a merger transaction with regard to employees are labour contingency (severance), acquired rights and joint liability.

Dominican laws are very protective of employees' rights, and the lawfully provided severance payment derived from the unilateral decision of an employer to terminate a labour contract can be quite high. Because of this, in some mergers, the labour contingency at the time of the merger is deducted from the price.

In accordance with Articles 76, 79, 80, 184, 203, 221 and 223 of the Labour Code, the severance payment and other benefits to be paid to an employee upon liquidation (when the employer unilaterally terminates a contract without justified cause) comprise:

- a. advance notice: this is the notice of termination of the contract. The number of days in advance on which the employee must be notified of the termination of his or her contract will vary depending on the length of time that the employee has worked for the company. If this period is one year or more of continuous work, the advance notice will be of 28 days. If the company fails to give this advance notice, then it must pay the employee 28 days' salary;

- b. severance: the payment of an amount equal to 21 days' salary for each year of service given;
- c. any outstanding wages;
- d. holidays, if the employees have not taken their holidays during the past year;
- e. a proportion of the Christmas salary, depending on the date of the termination; and
- f. a portion of the company's profits in the past year, if applicable.

The severance amount to be paid, and any other benefits related to it, are made proportionally to the amount of time the employer has worked in the company, which means that until the labour contract is terminated, and the employees are paid, the amount to be paid in connection with severance and employees' acquired rights will increase over time.

On the other hand, the acquired rights of employees are those benefits given to them in addition to those lawfully provided for: for example, life insurance policies, petrol payments and funeral expenses. Any modification or elimination of the acquired rights of employees constitutes a breach of the terms of the labour contract, which entitles the employee to dismissal with just cause and triggers the severance compensation indicated above.

Finally, the third scenario (joint liability) refers to the shared responsibility that is created when a company, a branch or an agency thereof is transferred or assigned, or employees are transferred to other companies,<sup>4</sup> including those rights and obligations of the employees that have been the subject of a lawsuit and are pending verdict, and in no case will void the acquired rights of the employees, whereby the new employer is jointly liable with the substituted employer for all the obligations resulting from the labour contracts or the law before the date of substitution.

In that vein, in an acquisition by share transfer, all the employees' acquired rights must be preserved, because the company continues its operation without there being any change in the terms of employment. Likewise, in a merger by absorption, the surviving entity assumes all the labour liabilities of the company that ceases to exist; if a new company is created, it assumes the liabilities of the companies that cease to exist.

In an asset purchase acquisition where there is no transfer of employees, in principle there are no labour liabilities to consider. However, if an employee transfer takes place, or a company sells all its assets to another company and the first one terminates the labour employment with the employees who are then hired by the company that purchased the assets within a period of less than two months, it can be presumed that the seniority of the employee continues in the labour contract with the buying company, and as such the employee will have the legal remedies to oblige the companies to comply with Dominican law. Nonetheless, the severance payment paid by the company that sold the assets may be deducted from future severance payments made by the acquiring company to the employees.

**VIII. TAX LAW**

The fiscal impact of a merger is covered mainly by the Tax Code, the Ruling for the application of Title II of Income Tax enacted by Decree No. 139-98 and Decree No. 408-10 of Business Reorganisation.

Prior to going through the merger process, and as per the terms of Article 94 of Decree No. 408-10, it is mandatory to inform the Tax Office of the intention to merge and request its approval to proceed with the merger.

Mergers, as stated in the above-cited three legal texts, are considered to be a form of reorganisation of companies, and as such the results that could arise as a consequence of the reorganisation are not taxed, and the rights and fiscal obligations that correspond to the entities that are reorganised will be transferred to the continuing entities. Notwithstanding, Article 287, Paragraph III of the Tax Code states that the losses that come from other entities as a result of a reorganisation process are not tax-deductible.

It is also important to note that the surviving entity in a merger, or the new entity created as a result of the merger, is liable for the obligations and taxes owed by its predecessor and for the penalties for the infringements of the companies that have ceased to exist, and it cannot oblige another entity to assume them.

On the other hand, acquisitions either by share transfer or by asset purchase are taxable transactions, with consequences for both parties (buyer and seller).

If a company decides to purchase the assets of an entity, to avoid acquiring the liabilities, it would have to pay the corresponding taxes for all the assets, and the tax rate to be applied to the transfer would depend on the type of asset that is being transferred. The tax on the transfer of real estate property amounts to 3 per cent of the sale price of each property or of the value of the property registered in the records of the Tax Office, whichever is higher. The same principle applies to the transfer of vehicles, but the tax rate here is 2 per cent. In both scenarios, the tax described lies on the buyer.

For the seller, the corresponding taxes that arise out of the transaction are paid on the yearly income tax, and will be the difference between the acquisition price (adjusted by inflation) and the sale price if it is a real estate property. For other types of tangible assets, the seller will pay income tax on the difference between the book value of the asset and the sale price. In both cases (sales of real state property and sales of tangible assets), the tax rate is 27 per cent.

The purchase price (except when transferring real state property or shares) should also include 18 per cent VAT for the sale of assets (other than real estate) that must be reported, collected and paid by the seller.

With regard to the transfer of shares, the seller is the one who bears the tax burden. In accordance with Article 289 of the Tax Code, the capital gain tax, which applies currently at a rate of 27 per cent, applies to sales, swaps and other allocation acts of capital assets, such as share transfers, in which the applicable tax is calculated by deducting from the price or the value of the transfer of the shares the cost of its acquisition adjusted by inflation (as per the multiplying factor published yearly by the Tax Office).

Moreover, Norm 07-2014, issued by the Tax Office, allows the Tax Office to estimate a minimum transfer value (sale price), regardless of the transfer value that the parties agree to in the agreement (sale price), and it takes into consideration the equity of the company whose shares are being transferred by dividing the result of the values for the paid-in capital, admitted reserves, accumulated benefit or losses at the time of the sale, revalorisation of the company equity and the surplus from the number of shares transferred. With this reasoning, the Tax Office determines whether there has been a capital gain or loss.

Norm 07-2011 issued by the Tax Office also requires that any company that acquires shares withholds 1 per cent of the price paid to the seller for the purchase of the shares regardless of whether the seller is an individual, a legal entity, a resident or a foreign national. Said payment is credited to the tax on capital earnings that has to be paid by the seller, generated on the occasion of the sale, if applicable.

## **IX. COMPETITION LAW**

On 16 January 2008, the Dominican Republic enacted Law No. 42-08 on the Defence of Competition. This Law prohibits the abuse of a dominant position and disloyal acts, such as agreements between competitors' market players, and promotes free competition. However, it does not regulate the concentration of capitals between the different players in a market.

Notwithstanding the above, several regulated markets require the authorisation of certain government dependencies, such as:

- a. Telecommunications: Law No. 153-98 and the Rules of Free and Loyal Competition of the Telecommunications Market require that any transfer, assignment, lease or grant of the right to use any title or lien granted on concessions or licences must be carried out with the previous authorisation of the Dominican Institute of Telecommunications (Indotel). In that vein, the sale or assignment of shares resulting in the loss by the seller or transferor of social control will require the authorisation of Indotel. Furthermore, mergers and market concentrations in telecommunications are expressly subject to the previous approval of Indotel, which can challenge a transaction or request and instruct correction measures in order for the transaction to be within the boundaries of the Law and the Rules.

- b. Banking: Monetary and Financial Law No. 183-02 requires that the authorisation of the Monetary Board is acquired in advance, as per Articles 9 and 35 of the Law, in cases of mergers, share transfers of 30 per cent or more of the paid-in capital, absorption, and substantial asset and liabilities transfers of any financial intermediation entity. The authorisation of the Monetary Board is also required in advance for currency exchange institutions.
- c. Securities: as per the terms of Articles 386 and 157 of the Companies Law, a corporation that had ventures in the securities market must submit the merger agreement to the Securities Superintendence, which will accept or reject the project within 15 days. The merger agreement is submitted for the approval of the bondholders' meeting, unless the companies involved allow that the bondholders can be offered a refund as the sole requirement. Moreover, Securities Law No. 249-17 sets out several provisions to avoid concentration.
- d. Insurance: Articles 174 to 184 of Dominican Insurance and Bonds Law No. 146-02 allow insurance and reinsurance companies to merge between each other with the previous authorisation of the Dominican Insurance Superintendence. The Superintendence can also recommend that an insurance company merges if the financial statements or the verifications made by the Superintendence reflect that the insurance company is not in a position to guarantee the fulfilment of its obligations before the insurers.
- e. Electricity: Paragraph II of Article 12 of the Ruling for the Application of the Electricity General Law No. 125-01, enacted by Decree No. 555-02, states that the Electricity Superintendence, before authorising the transfer of generation concessions, mergers or sales of shares where generation companies are involved, must investigate whether the petitioners, either by themselves or through related parties, are owners of generation centres with a total capacity that represents, in its opinion, a significant percentage of the maximum demand of the national interconnected electric system that, in accordance with the criteria established by the National Commission of Energy, constitutes a threat to free competition in the electric wholesale market. Article 82 of the Law establishes a similar prohibition on the transfer of concessions of generation and distribution.
- f. Pension funds: Article 93 of Law No. 87-01 of Social Security and Article 50 of Decree No. 969-02 that establishes the Pension Ruling, require that the merger is approved by the Pension Superintendence before completing matters of common law, and in that sense, a meeting approving a merger project together with the merger plan must be submitted. The Superintendence can require amendments to the merger project or reject it.
- g. Health risk administrators: similarly to pension funds as described above, Article 153 of Law No. 87-01 of Social Security states that health risk administrators and the National Health Insurance Scheme must obtain the express authorisation of the Health and Labour Risks Superintendence before merging with another entity.



**X. OUTLOOK**

Significant modifications to the Labour Code and Civil Code are being discussed, which could affect certain aspects of M&A. However, it is not known when these modifications to the existing laws, and the enactment of new laws, will be approved by Congress, considering that some Bills have been submitted for years.



**Appendix 1**

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**Preparado Por:**

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