

Private Equity 2017 - Colombia Questionnaire

1. What are the most common types of private equity transactions in your jurisdiction?

The most common types of private equity transactions in Colombia are: (i) acquisition capital, where private equity funds provide capital to operating companies via acquisitions, (ii) buy outs, both leveraged buyouts and management buyouts, by means of which a private equity fund typically acquires a control position, and (iii) turnarounds, where private equity funds provide equity with the intent of turning a distressed company into a financially stable company.

Most of the private equity transactions are what we call mid-market transactions or transactions that in price range between USD\$15 million and USD\$ 80 million. In addition in the last year we are seeing an important number of investments in real estate projects and infrastructure projects.

2. What types of investors are most active (and what jurisdictions are they most commonly from) in the private equity market of your jurisdiction?

In Colombia, pension funds, insurance companies, multilaterals such as the Multilateral Investment Fund (MIF), the Inter-American Investment Corporation (IIC), the Andean Development Corporation (CAF) and the International Finance Corporation (IFC), family offices and Bancoldex are playing an increasing role as investors in the private equity market. Most of the foreign funds investing in Colombia are commonly from the United States, Canada and Chile. Recently Colombia is seeing the presence of more funds with interests in investing in Colombia and neighbouring jurisdictions.

Please note that certain state-owned entities are creating programmes to promote the private equity industry in Colombia. Such is the case of the Colombian Development Bank (Banco para el Desarrollo Empresarial y el Comercio Exterior (Bancoldex)) which created the Bancoldex Capital programme designed to grant financial and non-financial support to Private Equity Funds (PEFs) oriented to invest in small and medium-growth companies. Bancoldex has invested as a limited partner in several PEFs, supporting economic sectors such as: outsourcing services, information technology, biotechnology, clean energy, digital animation, tourism, generation of energy and logistics, among others. As a result of this programme, in 2016 more than 44 companies have been capitalised and eight investment commitments have been made for USD\$31.6 million. These investments have allowed Bancoldex to multiplied it's resources 11.4 times, supporting 56 companies, 44 of which are Colombian.

In addition, there are other government sponsored funds that have recently been created as investment vehicles to allow state-owned companies to invest in social interest programmes. Also, the government is sponsoring funds with agricultural and agro industrial projects with the purpose of developing the rural sector in Colombia.

In accordance with the Colombian Association of Private Equity Funds (Colcapital), in Colombia there are about 55 professional managers of PEF's, about 89 PEF's and about USD\$ 11.140 million in investment commitments.

3. What historically have been the main target industries and what trends were noticeable throughout 2016? What trends do you expect to see in the next 18 months?

Private equity funds started to show important activity in the Colombian market in 2005, and the main industries where such funds have invested are as follows:

- real estate: investments in real estate properties to own and operate the corresponding properties (i.e, hotels, industrial parks, buildings, among others);
- infrastructure: investments in various public works (i.e, bridges, tunnels, toll roads, airports, ports, public transportation and other public works);
- real estate: investments in real estate properties to own and operate the corresponding properties (i.e, hotels, industrial parks); and
- general services: financial and insurance services, medical and health services, manufacturing, industrial sectors innovation technologies, biotechnology, telecoms, ports, among others.

Energy and extractive industry funds have been less popular during 2016-2017.

In general terms, Colombia saw a slowdown in the M&A market in 2016 compared with 2015. The main reasons for the slowdown relate to the effects of the global fall in oil prices, the high devaluation of the Colombian peso as compared to the US dollar and an appreciable increase in inflation, all of which have affected Colombia's economy. Nevertheless, throughout 2016, we saw several strategic acquisitions in Colombia by regional, international and local investors, and many of 2016's M&A activity will get to close in 2017. Also, according to Colcapital, there is a slowdown in regards to the creation of new private equity funds as compared with 2015 and during 2016 only 8 PEFs were created, mainly real estate and infrastructure funds.

Other examples of private equity deals seen in 2016, include:

- Brookfield completed the acquisition of 57.66 per cent stake from Ministerio de Hacienda y Crédito Público in Isagen, one the state's jewels being, one of the largest power generation companies in the country.
- Empresas de Energía de Bogotá and Empresas Públicas de Medellín sold their stake in Isagen to Brookfield completing its 11.2 billion pesos (USD\$ 3.7 billion) acquisition of Colombian Power Company.
- Ashmore Group completed the acquisition of 100% of the outstanding share capital of the first generation concessionaire "Concesión Santa Marta Paraguachón S.A."
- Victoria Capital Partners completed the acquisition and capitalization of Oncólogos del Occidente S.A. to obtain 67.14% of the outstanding share capital.
- Ashmore Andino II – FCP and Ashmore Andean Fund II, LP, both managed by Ashmore Management Company Colombia S.A.S., entered into an investment agreement with affiliates of Mechero Energy, Inc. to invest in a greenfield thermoelectric generation project in Colombia developed by Termo Mechero Morro S.A.S. E.S.P. Upon closing of the transaction, Ashmore Andino II – FCP and

Ashmore Andean Fund II, LP will hold a controlling stake of Termo Mechero Morro S.A.S. E.S.P.

- Fondo de Capital Privado Inmobiliario Colombia, controlled by Fiduciaria Bancolombia, acquired 49% of Viva Malls from Almacenes Éxito. The deal value was US\$ 263 million.

At the end of 2016 equity activity started to be driven by the first wave of divestment by private equity funds of initial investments made over the past six years, following the natural maturity of their investments in local assets. Such divestments are underway and have not yet been executed but we expect they will occur within the following months. As mentioned before, if the Colombian peso continues to devalue with respect to the US dollar, as has occurred during the last years, Colombian assets will be cheaper for foreign investors paying with hard currency, which will benefit international private equity funds.

In 2017, we expect to see private equity deals in the infrastructure, real estate, financial services (including regulated and non-regulated), retail sales and services.

During the following 18 months, we expect to see M&A opportunities involving infrastructure projects. The Colombian National Agency of Infrastructure (ANI) has created a fourth generation concession program which has opened several public bidding processes to award fourth generation concessions as part of the plan of the national government to revamp the country's infrastructure. The high equity requirements of these fourth generation concessions are the main reasons why M&A opportunities in this area will arise, as current actors involved in these concessions do not have all the equity required, and their current credit exposure with banks is reaching the allowed limits. In that sense, some local players may be cashing out of some of their projects to use such resources in the remaining projects..

4. Please describe the main features, size and activity levels of local private equity funds. Are there any regulatory or market restrictions or incentives to the development of any such local funds? Have any begun to participate significantly in transactions out of their local jurisdiction?

In Colombia, PEFs are considered closed collective investment portfolios, created pursuant to an offering memorandum that contains the regulations of the fund and to which the investors adhere when executing an investment commitment. Consequently, a Colombian PEF does not have a corporate nature (i.e., limited partnership) but rather a contractual nature (i.e., a portfolio with assets separate from those of its manager).

Generally, we are seeing that local funds are ranging between US\$50 million and US\$200 million. A typical Colombian PEF has the following participants:

- a management company: stock broker dealers, trust companies or investment management companies, all entities under the surveillance of the Superintendence of Finance (SFC). The management company carries the PEF's back-office activities and reporting obligations to SFC and may choose to appoint a professional manager, which is generally the case;
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- professional manager: in charge of the investment activities of the fund (due diligence, overview and divestitures). It appoints the investment committee;
- investment committee: PEFs must have an investment committee that serves as an advisory body to the professional manager regarding investments strategies and the definition of limits and maximum investments per issuer and the settlement of investments;
- general assembly of investors: the investors constitute the general assembly of investors. The general assembly of investors requires a quorum to deliberate constituted with a plural number of investors whose units represent at least the 51 per cent of the outstanding units of each PEF. The decisions of the general assembly of investors shall be taken with the favourable vote of half plus one of the units represented in the respective meeting. Each unit grants one vote to its holder.
- oversight committee: this has a surveillance function over the activities of the management company and the professional manager, and is appointed by the general assembly of investors.
- custodian: Decree 1,242 of 2013 (“Decree 1,242”) issued by the Ministry of Finance sets forth that custodianship of securities shall not be performed by management companies of PEFs. As of the enactment of Decree 1,242, custodianship of securities held by PEFs must be performed by entities authorized by the SFC to act as custodians (trust companies) and such entities shall be deemed independent to the management company. If determined by the management company, custodians may be responsible for the accounting and tax obligations of PEFs.
- incentives: PEFs allow channelling resources to investments that certain institutional investors (ie, pension funds primarily) would not be able to do. In fact, PEFs are authorized to invest in securities issued by special purpose vehicles developing infrastructure projects, and allowed as well to purchase accounts receivables originated in infrastructure projects. Decree 816 of 2014 enacted by the Ministry of Finance increased investment limits applicable to mandatory pension funds when investing in PEFs which in turn invest in infrastructure projects. Also, Decree 2,103 of 2016, enacted by the Ministry of Finance, increased the investment limits applicable to mandatory pension funds when investing in PEFs which in turn invest in real estate projects.
- In addition, Decree 1,385 of 2015 enacted by the Ministry of Finance authorized mandatory pension funds to invest in PEFs investing in securities issued, accepted or guaranteed by the same pension fund (or a related party of such pension fund), provided (i) the PEF destines two thirds of the contributions of its investors to invest in infrastructure projects, (ii) members of the investment committee and the general partner must be independent from the pension fund administrator, and (iii) the value of the participation units of the pension fund in the PEF must not be greater than 50% of the net worth of the PEF.
- Furthermore, Decree 1,403 of 2015 issued by the Ministry of Finance amended Decree 1,242 authorizing PEFs to invest 100 per cent of their commitments in real estate assets without being considered a Real Estate Investment Fund (*fondo de inversión colectiva inmobiliarios*).
- Restrictions: Pension funds can only invest in PEFs that are exclusively offered to professional investors. The professional manager must meet certain experience requirements.

- Tax matters: note that the general rule applicable to open and closed collective investment portfolios have a tax treatment by which the first payment of their investments are deemed as profit and consequently the withholding tax applies upon redemption. Nevertheless, in 2014 the Ministry of Finance enacted the Decree 1,859 (now compiled in article 1.2.4.2.86 of the Decree 1,625 of 2015), which introduced a paragraph to article 1 of the Decree 1,848 of 2013, applicable exclusively to PEF's. Such paragraph sets forth that withholding tax is only applicable when the PEF is actually distributing profits and not when it is simply returning the capital invested. After redeeming the entire investment, following payments will be considered as profit, hence, withholding tax will apply.

Some Colombian private equity players have recently expanded out of Colombian jurisdictions to make investments in Peru, Mexico and other similar jurisdictions.

5. Are there any private equity funds listed in your jurisdiction? Are there any special regulations or requirements applicable to the listing and public offering of securities by such funds or any reform initiatives that are under discussion?

In Colombia there are some private equity funds registered in the Colombian securities register (RNVE) and few private equity funds listed in the Colombian stock exchange (BVC).

As per Decree 1,242, participation units issued by a PEF may be registered in the Colombian securities register (RNVE) if determined so by the management company in the offering memorandum. The registration of the units in the RNVE is one of the required steps to list such units on the Colombian stock exchange (BVC) or to allow its negotiation in private registry systems (*sistemas de negociación de operaciones sobre valores*). In addition to the registration in the RNVE, the units also need to be registered in the BVC. The process of registration in the BVC and public offering of the PEF units are no different than those applicable to a typical corporate.

It is worth mentioning that once a PEF is listed on the BVC, it will be necessary for it to adopt certain corporate governance rules applicable to listed entities.

6. What are the main issues in connection with the liability of fund managers?

Under Decree 1,242, the management company and its board members owe fiduciary duties to the investors. However, if the management company decides to appoint a professional manager, then its liability is limited to the act of election of the professional manager and its adequate supervision. Generally the liability of the fund managers is regulated in the offering memorandum.

7. What are the main remuneration schemes and related features for fund managers and have there been any recent shifts observable in the market? Are there any limitations or reforms under discussion regarding the same?

The same as the standard international remuneration schemes:

- carried interest: 20 per cent;
- management fees: up to 2 per cent; and
- organisational costs, generally with a cap.

On this matter it is worth mentioning that the 20 per cent ‘carry’ is generally paid as a cost of the fund. However, with the different types of participation units that can be issued by a PEF as per Decree 1,242 (see answer to question 30), the “carry” can be deemed a right of the professional manager when acting as investor of the PEF.

In addition, the market is beginning to see reduced management fees well below the 2 per cent mark. Institutional investors, particularly pension funds generally require that prior to the end of the investment period the management fees are low and based on the amount of the investments commitments and increase gradually until the end of the investment period. Upon the end of the investment period the percentage is calculated over the assets under management.

8. Please describe any legal considerations of particular importance in your jurisdiction in connection with executing leveraged buyouts and similar strategies.

For many years, leverage buy-outs were restricted for local financial institutions in Colombia. In fact, article 72 of the Financial Organic System Statute (EOSF) sets forth that the entities under the surveillance of the SFC, its officers and directors, legal representatives, fiscal auditors and employees shall refrain to ‘use or facilitate’ the resources obtained from the public to acquire the control of target companies without legal permit.

Currently, as a general rule, except expressly permitted under Colombian regulations (ie, financial corporations), entities under surveillance of the SFC may only undertake transactions to facilitate control acquisition of target companies as long as the resources from its clients are not being used, which means that these transactions may only be undertaken with the entity’s own funds (article 12.1.1.1.2 of Decree 2555 of 2010).

In 2009, Law 1,328 expressly authorised commercial banks to grant loans to acquire the control of target companies, except on the cases foreseen in article 10(c) of the EOSF, which means that currently commercial banks are allowed to facilitate credits to acquire the control of entities that are not under the surveillance of the SFC while there is an express prohibition to grant such credits to acquire the control of surveilled entities (except on specific circumstances).

Please note that the above is only applicable for local financial institutions, which means that any Colombian or foreign entity may structure a leverage buy out transaction of a financial institution without the above mentioned restrictions as long as the purchaser seeks to obtain financing from foreign financial institutions.

As a result of Law 1,328, we have seen a growing confidence among banks that are likely to assume higher risks in M&A financing due to Colombian assets becoming more trustworthy and due to the high liquidity and funds available they have for corporate acquisitions at very competitive rates compared to debt raised on the capital markets. In fact, in 2016 we saw very few local debt offerings aimed at financing acquisitions, as investors preferred to turn to local and regional banks to leverage their acquisitions and business development projects.

For example, in 2015 we witnessed the single largest financing ever structured in Colombia and the largest ever acquisition financing in history: COP 3.5. Billion acquisition financing to Almacenes Éxito from a syndicate of Colombian banks formed by Banco Davivienda S.A.,

Banco de Bogotá S.A., Banco de Occidente S.A., Banco Popular S.A., Banco AV Villas S.A., Leasing Bancolombia S.A. for the acquisition of Libertad and Grupo Pao de Azucar.

9. What are the main organisational forms used in your jurisdiction to channel private equity investments? Has there been any change over time in the types of organisational forms used? What are the main formation requirements?

In general terms the typical organizational forms are either corporate structures (i.e. corporations and limited liability companies, being the *Sociedad por acciones* simplificada the most corporate structure most used these days) or PEF. In fact, we are recently beginning to see a trend of certain corporate structures reorganizing such structures into PEF's with the idea of having a more flexible structure that allows for easier growth and also that permits the receipt of investments from institutional investors. This trend is particularly strong in real estate businesses but we foresee them applicable to other sectors of the economy.

As an alternative to traditional bank financing, domestic companies have continued to turn to private equity funds seeking fresh capital (equity or mezzanine financing) in order to finance acquisitions. Private equity funds are closely monitoring and balancing risk and return under their equity investment and mezzanine financing devoted to these types of deal. Financing in Colombia for 2016 has come from domestic and foreign banks and private equity funds mainly.

As indicated, there are a few examples of leveraged buyouts, but in our experience a rough estimate of the ratio between debt funds and self-funded resources (buyer's own resources) in these types of deals would be 40:60. Notwithstanding, every time there are more financing resources available in the Colombian financing market, where target companies are being used as borrowers of such financings.

We expect to see investment banks, affiliated to commercial banks, being more active in the market, structuring not only the sale part of an acquisition but also the required financing for the same transaction, combining the acquisition and financing in one package.

10. What are the most important legal issues arising in the operation and governance of local companies in your jurisdiction?

As to the operation and governance issues of local companies, we consider important for investors to acknowledge the main corporate bodies of Colombian stock corporations (commonly used type of companies incorporated as *sociedades anonimas* or *sociedades por acciones simplificadas*, in which shareholders are liable for the corporation's debts up to the amount of their respective capital contributions):

- general shareholders' meetings. The ordinary meeting must take place on the first quarter of each year in order to discuss and approve, among others, the financial statements of the company for the previous year and declare distribution of profits. Extraordinary meetings can be held at any time to discuss any particular matter within the powers of the general shareholders assembly;
- a general manager who is empowered to execute any act or agreement contemplated in the corporate purpose of the company's by-laws, or which is directly related with the existence and operation of the company. Notwithstanding the above, the company may limit the powers or faculties of its manager by establishing such limitations in the

company's by-laws, which shall be registered in the Chamber of Commerce of the company's domicile. Finally, it is important to mention that as a general rule, there is no limitation for the company's manager to be at the same time an employee of the company;

- a board of directors, composed by at least three principal members and their alternates, are in charge of the day-to-day administration of the company. A board of directors may not be required in the case of simplified stock corporations if expressly set forth in the company's by-laws;
- in some cases it is also imperative to appoint a statutory auditor duly registered as public accountant in Colombia.
- additionally, it is important for investors to consider that under very limited circumstances provided under Colombian Law, relevant authorities may pierce the corporate veil and the shareholders may be held liable for the company's liabilities, as further described below:
- article 61 of Law 1,116 of 2006 establishes a presumption setting forth that the insolvency of a subsidiary might have been caused as a consequence of the parent company's controlling actions, except the parent or controlling company evidences that its actions did not cause the insolvency of its subsidiary and were not taken in the interest of the parent or its affiliates and against the subsidiary. If the presumption is not rebutted, the parent or controlling company will have subordinated liability with its subsidiary for the obligations of the latter; and
- article 60 of Law 1,116 of 2006 sets forth that if the assets of the wound up company are insufficient to pay all external liabilities of the latter, the liquidator will be able to demand to the shareholders the payment of the unpaid shares of the company and to cover the additional liability established in the by-laws of such company.

Finally, in the case of Colombian stock corporations, it is important to consider governance rules, disclosure requirements and minority rights (see question 12).

As per governance issues in PEFs, management companies must act in a professional manner, with the diligence required for a prudent expert in the management of funds and in accordance with the investment policy of each fund. In this sense, management companies have fiduciary duties before the investors and are liable for slight negligence in the performance of their activities as managers of the PEF. Consequently, management companies are subject, among others, to the following duties with the investors of PEFs.

- information: management companies must implement policies and procedures to ensure that the information to be delivered to their investors or prospective investors is objective, opportune, complete, impartial and clear. As minimum, basic general financial statements, the general description of the portfolio, the evolution of the participation value, the value of collective portfolio and the participation of each investor therein shall be submitted.
- conflict of interest: as a general rule, management companies must refrain from acting in cases of conflict of interest in accordance with the minimum standards required under Decree 1,242. In addition, such entities must implement principles, policies and procedures in order to detect, prevent and manage potential conflicts of interest. When acting on behalf of PEFs, management companies must give prevalence to the interests of the investors over their own interests or any third party's interests, including the management companies' shareholders, officers and affiliates.

- confidentiality: management companies are bound to keep the reserve and confidentiality of the transactions performed by their investors, unless in the cases expressly exempted by law.

It is worth mentioning Law 1,607 of 2012, which among other matters in the area of corporate taxation brought the following: (i) established new regulation regarding the concept of permanent establishment, and defined the idea of the effective place of management for purposes of determining corporate residency and its tax obligations; (ii) set forth rules on tax effects of the distribution of profits by branches of foreign corporations and permanent establishments; (iii) adopted thin capitalization rules; (iv) introduced changes on the regulation of corporate reorganizations (such as mergers and spin-offs) in order to tax some of these operations; and (v) adopted general anti-avoidance rules.

Then, on December 23, 2014, the Colombian Congress enacted Law No. 1,439, which amended the Colombian tax code. Although this law did not had an impact in M&A activity directly, it created the “wealth tax” for fiscal years 2015 through 2017 for both resident/domiciled entities and foreign non-resident/non-domiciled entities holding wealth in Colombia, which may have impacted Colombian investment. Nevertheless, it is important to bear in mind that stock held in Colombian companies was excluded from the baseline used to calculate net worth for wealth tax purposes.

On December 2016, the Colombian Congress approved Law 1,819, a so-called “structural tax reform” that took effect on January 1, 2017. This tax reform includes, among others: (i) the imposition of the financial transaction tax (“GMF”) as permanent; (ii) an increase on VAT rates and broadness of the taxable events; (iii) the elimination of the special corporate income tax (CREE tax) which was created by Law 1,607 of 2012, and the corresponding increase of the corporate income tax rate, (iv) a modification of withholding tax rates on foreign payments, (v) a modification and limitation of tax deductibility, (vi) the introduction of Controlled Foreign Company (CFC) rules, (vii) the introduction of IFRS as a base for determining taxable basis for income tax purposes, and (viii) a taxation on dividends, among others.

11. Are there any issues to be considered in connection with the limitation of liability under the laws of your jurisdiction?

As mentioned above, the members of the oversight committee are appointed by the investor’s assembly. As a general rule, the liability of the members of the oversight committee is a personal liability and shall not compromise the liability of the investors who appointed such member. Notwithstanding the above, the matter is not free from doubt as to whether an investor having the right to appoint a member of the oversight committee and such member’s subsequent role on giving of consents and approvals through such committee in the manner instructed by an investor, would cause such investor to lose the limited liability established that is generally set forth in the offering memorandum. We believe the better view is that it should not affect such limited liability, provided however that the decisions taken by the oversight committee member and the instructions of the respective investor are free of fraud, wilful misconduct, gross negligence and are not in breach of laws or the offering memorandum.

12. What are the most common minority protection rights, whether granted by operation of law or contractual agreement? Are there any special issues to be considered under the laws of your jurisdiction?

In the Colombian legal system, the majority rule controls the decision-making of corporate entities. Nevertheless, there are several minority protection rights that are foreseen under Colombian regulations, such as the following.

- the right to participate and vote in shareholders' meetings: in order to deliberate, the presence of at least two shareholders, depending on the type of corporate entity, representing the absolute majority of subscribed shares is necessary. Decisions are made, as a general rule, with the absolute majority of votes present in the corresponding meeting. Please note that shareholders have the right to be represented at the shareholders' meetings by means of a power of attorney without the requirement of any legalisation formalities.
- super majorities: according to Colombian law, the following decisions require special super majorities in order to protect minority shareholders: decisions approving distribution of profits below the percentage established by the law (50 per cent) will require at least the favourable vote of 78 per cent of the shares present in the corresponding meeting; the waiver of pre-emptive rights upon the issuance of shares if the favourable vote of at least 70 per cent of the shares present at the meeting is obtained; and the approval of payment of dividends by way of shares will require the favourable vote of at least 80 per cent of the shares present at the corresponding meeting.
- summoning of shareholders' meetings: shareholders representing 25 per cent of the issued and outstanding capital of the corporation have the right to request the legal representative of the company, which is generally the chief executive officer of the company, to summon an extraordinary general shareholders' meeting.
- inspection rights: directors and officers shall permit the shareholders or their representatives, the exercise of their right of inspection at the company's main place of business of the company's books and records during a 15 business day period prior to each meeting at which financial statements are to be approved (generally, ordinary annual shareholders' meetings).
- Pre-emptive Rights and The Right Of First Refusal: The Colombian Code of Commerce establishes that shares are freely negotiable except for cases where pre-emptive rights and the right of first refusal are established in the by-laws.
- the right of withdrawal: the right of withdrawal (appraisal rights) is a protection contained under Colombian corporate law, which applies in cases when the transformation, merger or spin-off of a company, imposes a higher liability on the shareholders, or implies a detriment to their economic rights. The withdrawal right may be exercised by: shareholders who did not attend the meeting of the corporate bodies where the respective decision was adopted; or shareholders who voted against such decision. Please bear in mind that the right of withdrawal does not apply in transactions such as purchase of shares.
- directors' liability: with respect to the legal actions that may be taken by the company against its directors, article 25 of Law 222 of 1995 (Law 222) provides for a derivative action that may be filed by the company, prior affirmative decision of the shareholders meeting, irrespective of whether such item was included in the agenda for the corresponding meeting. The summoning of this meeting may be made by a plural number of shareholders representing at least 20 per cent of the company's interest. If

the decision is taken, and the action is not filed within three months, said action may be presented by any officer or director denominated as “administrators” under Colombian law, the auditor or any shareholder on behalf of the company.

Notwithstanding the above, please note that shareholders agreements may include additional contractual provisions to protect minority shareholders, such as mechanisms to control the decision-making of the corresponding entity (ie, veto rights and sunset provisions), co-sale rights (which permits a stockholder to ‘tag along’ and have his or her shares purchased as part of another stockholder’s sale to a third party), and resolutions of disputes allowing an exit to the shareholders. The enforceability of such mechanisms is further described in question 15.

The Superintendency of Corporations in the use of its jurisdictional attributions has developed clear standards for the decision-making process of boards of director or special committees adopting the business judgement rule standard used by Delaware courts. According to such standard, directors must take decisions for the benefit of the company with all due information (ie, counting with the proper legal advice and fairness opinions from suited firms in the respective industry).

The Superintendency of Corporations has also applied the entire fairness test when a conflict of interest exists for the directors making a decision. In such events, the Superintendency has evaluated whether the decision was made under the standards of fair dealing (ie, the transparency and fairness of the decision making process) and fair price or fair consideration (ie, the adequacy of the terms and conditions of the transaction).

13. What are the main exit strategies used by private equity investors in your jurisdiction? Are there any limitations to the availability, effectiveness or enforceability of exit arrangements that are commonly used in other jurisdictions? Have you seen a shift away from or towards certain exit strategies over the past year?

Among the main exit strategies used by private equity investors, we would like to mention the following:

- sale to strategic investors;
- sale to PEFs;
- sale to institutional investors
- sale in the securities market through an initial public offering (IPO); and
- sale to initial shareholders (sale-back through a put option).

The IPO is an ideal exit mechanism since it is usually in the interest of all the shareholders to assure the access of the company into the securities market and allow a transparent exit strategy. In Colombia, the shareholders of a closely held corporation that wish to list the corporation in the Colombian Stock Exchange and sell their shares to the public must register the company and the shares before the RNVE; and the company must list the securities before the BVC. Once they are listed in the BVC, the shareholders may sell their shares in a secondary offer (i.e., ordinary sale, auction or ‘pre-agreed’ sales) or jointly with a primary issuance of shares, in which case the existing shareholders would only be allowed to include their shares in the offering up to a 100 per cent of the total amount of the securities being offered. For example, if 200 shares are going to be issued, 100 shares have to be from the primary market and 100 shares from the secondary market.

There are no limitations as to the enforceability or effectiveness of the exit arrangements. Notwithstanding that the IPO is an ideal exit strategy, we have recently seen sale-back transactions and sales to strategic investors as trending exit strategies.

Furthermore, the integration of the stock exchange markets of Colombia, Chile, Mexico and Perú (MILA) is a great exit strategy for private equity funds, with greater diversification for investor and access to the capitals markets. Currently, the MILA is the first market in regards to listed companies in Latin America.

14. What are the key legal issues to be considered when appointing or replacing directors and officers?

Law 222 considers any of the following individuals as officers and directors under Colombian law (who are denominated as administrators): legal representatives of the company, its liquidator, members of the board of directors or other committees and the representatives of a company's commercial establishments. In addition, Law 222 contains a blanket provision that includes within the concept of administrators those individuals that, pursuant to a company's by-laws, hold or have powers such as those given to the above mentioned positions (ie, decision making positions).

Under these circumstances, Law 222 establishes that directors and officers shall act in good faith, with loyalty and with the diligence of a good business person and establishes several duties that directors and officers must observe, such as the following:

- perform all the necessary actions in order to carry out the corporate purpose;
- comply with all the legal provisions and with the company's by-laws;
- allow the adequate fulfillment of all the tasks entrusted to the company's statutory auditor;
- guard and protect the commercial and industrial property of the company.
- abstain from improperly using privileged information;
- give an equitable treatment to all shareholders and allow them to exercise their 'inspection rights'; and
- abstain from participating, directly or indirectly, either for their personal interest or for that of third parties, in any activities that imply unlawful competition with the company or in acts that may give rise to a conflict of interest, unless there is a prior authorisation of the shareholders meeting.

The general rule with respect to directors' liability is that they shall be jointly and severally liable for all damages caused, without any limit, to the company, its shareholders and third parties, because of negligence or wilful misconduct. Please note that D&O insurance policies are available in the Colombian market.

Finally, it is important to point out that any provision in the by-laws limiting directors' liability or exempting directors from their liability are understood by Law 222 as not existing.

Please note that if investments are being made in entities under the surveillance of the SFC, additional requirements may be considered when appointing directors and officers. In fact, according to financial regulations, the appointment of legal representatives, members of the board of directors, administration committees, compliance officers, and financial ombudsman, requires the clearance of the SFC, and for purposes of obtaining such clearance, the SFC

undertakes an evaluation of the corresponding individuals based on their working experience as well as on their professional and moral qualifications. As a general rule, the replacement of directors and officers shall only become effective until obtaining the clearance by the SFC of the newly-appointed director or officer.

Finally it is worth noting that public companies have additional requirements regarding the need of independent members of the board of directors. As a general matter, in public companies at least 25 per cent of the board must be comprised of independent members. Public companies do not contain the type of independence requirements. However, it is common to find that, as a matter of best corporate governance practices, private companies have adopted these practices.

15. Please describe the most significant issues commonly considered under the laws of your jurisdiction in connection with purchase and shareholders' agreements.

The M&A market is becoming more sophisticated and demanding, and the need to achieve international standards has become a priority. The documentation for these deals is usually drafted in English, following common law practices; even if the share purchase agreement (SPA) is drafted in Spanish and governed by Colombian law, in large M&A deals (commonly involving a foreign party) the SPA would follow the typical New York-style SPA format (eg, definitions, acquisition of shares, purchase price, representations and warranties, conditions to closing, covenants, indemnification, termination, non-compete, dispute resolution and miscellaneous, etc.). Of course, when using the New York-style SPA for a deal governed by Colombian law, one should be very careful in using the appropriate Colombian applicable legal terms and forms and dropping NY law provisions not applicable under Colombian law (eg, equitable relief, waiver of jury trial, punitive damages, consequential and indirect damages, best efforts, specific performance, etc). Currently, there are no major significant differences between domestic and international deals. It could be said that civil/common law differences have been reduced when negotiating and documenting an M&A deal, to some extent thanks to front-runner law firms adopting a global standard to handle cross-border deals, which they apply to both domestic and international transactions. However, caution must be observed when using certain New York-style provisions for Colombian law governed SPAs since certain New York law provisions do not work under Colombian law.

For example, regarding representations and warranties and breaches thereof, there are not as many precedents and case laws in Colombia testing these kinds of provisions as compared to other jurisdictions such as New York. In Colombia, there are a handful of recent arbitration awards enforcing and giving full force and effect to indemnification due to the breach of representation and warranties under New York-style agreements (governed by Colombian law) and one judicial precedent that gives full force and effect to representations and warranties, the absence of which will not cover under Colombian law the underlying assets of a target company (only the shares of the target company being sold). We are not aware of any precedents not enforcing or disregarding these types of provisions or indemnity structures, but it should be noted that these provisions are new to arbitrators and judges and contractual remedy for such breach should be explicit under Colombian law.

Colombian law will recognise as valid the choice of a foreign law as governing law provided it is subject to a valid international arbitration clause under Colombian regulations. Assuming there is no fraud in the selection of the applicable law and that the selection of the law does not have as its object to escape from or violate an otherwise applicable public policy

provision, there are no limitations in Colombian law as to which substantive law may be agreed upon to govern an agreement where the disputes that arise in connection with such agreement are subject to an international arbitration clause. In the presence of a valid international arbitration clause, Colombian law does not require any specific points of contact between the law which is selected to govern the agreement and the parties or the place of performance or execution of the agreement itself.

Other good examples are the terms ‘material adverse effect’, ‘material adverse change’ and ‘best efforts’. These terms are not regulated under Colombian law and, when taken alone, have little meaning or effect under local law or may even conflict with local law forms as *force majeure* or good faith obligations that all parties must comply with. A way to avoid confusion and ensure accurate interpretation by arbitrators of such terms, in the case of a dispute, could be to include definitions of such terms under the SPA that are comprehensive enough to afford the arbitral tribunal sufficient basis for determining the agreement of the parties, the legal effect intended by the parties and to give full effect and correct interpretation of such terms.

In addition, for purposes of negotiating the indemnity under the SPA, it is worth to consider that Colombian Law only provides for direct damages in the form of actual damages and loss of profit or benefit, unless the latter is expressly limited by law, and within the following scope:

- in the case of negligence, the liable party will only be responsible for direct damages that were foreseen or could have been foreseen at the time of the contract; and
- in the case of bad faith, gross negligence or wilful misconduct, the liable party will be responsible for all direct or immediate damages even if they were unforeseeable direct damages.

Colombian law does not incorporate the concept of consequential or indirect damages therefore any agreement or wording contractually agreed by the parties in such regard will not be enforceable before a court.

Finally, please note that for many years, there was no certainty as to the enforceability of non-compete clauses under Colombian law considering Colombian antitrust regulation prohibits any agreement which has the purpose or effect of limiting or refraining from producing a good or rendering a service. In that regard, the Superintendency of Industry and Commerce (SIC) issued opinions setting forth that every non-compete agreement would be deemed banned since it would be viewed as an illegal limitation of free competition, therefore with an unlawful purpose. Nevertheless in a resolution issued by the SIC in 2010 (Resolution 46,325), while adopting international standards, the SIC set forth that non-compete clauses in M&A deals could not be considered per se as restrictive of free competition without analysing the scope of the clause and its actual impact in the relevant market.

In relation with the shareholders’ agreements and its applicability, Law 1,258 of 2008 creates simplified stock corporations which permits that the shareholders’ agreements deposited at the company’s offices may be validly executed without any limitations. Any shareholder could demand the compliance of the shareholder’s agreement before the Superintendence of Corporations, which encourages confidence in private equity investments.

Other than the deposit requirements described above, shareholder agreements do not have any additional execution formalities as they are considered private agreements.

Finally, Law 1,778 of 2016 adopted measures against foreign bribery, and therefore representations and warranties regarding compliance with the Foreign Corrupt Practices Act and the UK Bribery Act are currently not only involved in acquisitions with a US or UK buyer or a multinational with substantial links to the United States or United Kingdom, but are becoming every time more common in the case of pure local acquisitions, making reference to local anti-corruption rules (eg, Law No. 1,474 of 2011). If the acquisition involves bank financing, it is even more common to see anti-corruption representations and warranties and even specific reference to OFAC and other listings.

16. Please describe the main issues related to dispute resolutions under purchase, shareholders' and other principal private equity agreements. What are the most common dispute resolution mechanisms selected in these agreements?

It is very important to draft a clear arbitration clause in all private equity agreements in Colombia and even more important to be extremely careful with technical pre-arrangements to settle the dispute, as they might affect the validity of the arbitral holding. A favourable legal framework for international arbitration exists in Colombia.

The most common dispute resolution mechanism selected in principal private equity agreements is international and domestic arbitration. However, certain entities prefer to include forum selection clauses in their agreements. Under Colombian law, forum selection clauses designating the exclusive jurisdiction of foreign courts entail significant risks, unless a substantial part of the obligations are performed outside Colombia. If performance takes place in Colombia, courts tend to disregard clauses providing for the jurisdiction of foreign courts.

The New York Convention and Law 1,563 of 2012 (the Arbitration Statute) govern the recognition and enforcement foreign arbitration awards and arbitral agreements. The Arbitration Statute governs an international commercial arbitration seated in Colombia.

The Arbitration Statute adopts a dual arbitration system which sets forth different rules for domestic arbitration and international arbitration. The arbitration is qualified as 'international' in the cases provided for under article 62.

Only disputes which concern matters that may be directly settled by the parties or authorised by law can be submitted to arbitration (Arbitration Statute, articles 1 and 62; Constitutional Court, Decision C-098/01). Pursuant to Colombian statutory law and the judgments of the Constitutional Court, certain matters may not be settled through arbitration.

In international arbitration the parties are free to determine the language of the proceedings (Arbitration Statute, article 95). In domestic arbitration, proceedings shall be held in Spanish (Colombian General Code of Procedure, article 104).

In the case of international arbitrations seated in Colombia, as per article 73 of Arbitration Statute, the parties are free to agree on a procedure of appointment of arbitrators.

In domestic institutional arbitration, as per article 8 of the Arbitration Statute, '[t]he parties shall jointly appoint the arbitrators, or delegate this task – in whole or in part – to an

arbitration centre or a third party. Arbitration centres shall always make the appointments entrusted to them by random selection, from a list of lawyers specialized in matters related to the subject matter of the dispute...’

In international arbitration, unless otherwise agreed by the parties, the arbitral tribunal is empowered to grant interim relief at the request of either party (Arbitration Statute, article 80). Under the domestic arbitration section of the Arbitration Statute, arbitrators are also empowered to adopt interim measures in arbitral proceedings at the request of either party (Arbitration Statute, article 32). The granting, enforcement and elimination of such measures shall be governed by the Colombian General Code of Procedure and the Code of Administrative Procedure. The tribunal can request assistance from local judges in the enforcement of interim measures.

Recognition of foreign arbitral awards and judgments must be submitted before the Civil Chamber of the Supreme Court of Justice. In the case of foreign arbitral awards, if a Colombian state entity is involved, the claim for recognition must be submitted before the Council of State. If recognition is granted, enforcement proceedings may be commenced under the provisions of the Colombian General Code of Procedure. Recognition of a foreign arbitral award may be refused only on the grounds set forth in article 112 of the Arbitration Statute. Recognition of a foreign judgment may be refused only on the grounds set forth article 606 of the Colombian General Code of Procedure.

17. What are the most common funding structures? Are there any significant issues commonly confronted in implementing such structures?

The most common funding structures are capital increases, irrevocable contributions, private placement of debt and debt offerings in international markets. There are no minimum holding periods.

Please note that transfer pricing rules are applicable, for Colombian income tax purposes, to the transactions performed by income taxpayers with foreign related parties. Thus, income taxpayers must determine their assets, liabilities, income, costs and expenses, for income tax purposes, on the basis of prices and profit margins used in comparable transactions entered into with or between independent or unrelated parties.

18. Is there a domestic financing market for private equity deals? Has there been a shift in the sources of funding over the past few years? Where do you expect to see financing come from in the next 18 months?

The Colombian market has a high level of liquidity and the market has seen important financing transactions with only domestic financing. However, foreign financing is still highly competitive especially for transactions of considerable amounts. In any case, under applicable Colombian regulations, interest income earned by the lenders resulting from foreign currency long term loans entered into by Colombian borrowers will be subject to income tax withholding in Colombia, which is currently at 15 per cent.

Over the past few years, as an alternative to traditional bank financing, domestic companies have turned to private equity funds seeking fresh capital in the form of equity investments and mezzanine financing in order to finance working capital, expansion plans and acquisitions. Private equity funds also present an excellent investment opportunity to procure local

resources from institutional investors such as pension funds and insurance companies that can later be injected into healthy companies of several economic sectors with capital needs.

In 2016, we saw a good number of private equity deals (by private equity firms and regulated private equity funds) and expect to see more of this type of deal, mainly in the infrastructure, retail, real estate, regulated and unregulated financial services, and energy sectors.

Finally, as part of the financing for new infrastructure projects, privatization of state assets will continue to play an important role in 2017. We also expect to see the privatisation of government stakes in order to raise enough funds to secure the development of the fourth generation route concessions, the on-going Public Private Partnerships and other infrastructure projects. However, it is important to consider that the environment for new private equity has shifted, with a decreasing trend in 2016 in comparison with 2015, as per the information provided by Colcapital.

19. What are the principal accounting considerations that arise in private equity transactions? Are there any contemplated or ongoing shifts in regulatory accounting standards in your jurisdiction?

Law 1,819 of December 29, 2016 (the “2016 Tax Reform”) establishes that the income, costs, expenses, assets and liabilities necessary to assess the income tax due would be determined based on the International Financial Reporting Standards (“IFRS”) as adopted to Colombian context (certain specific rules are applicable for tax purposes). Based on this, upon the entry into force of the 2016 Tax Reform, the legal references to the accounting rules made in the Tax Code shall be understood to be made in respect to IFRS.

20. Are there any disclosure, registration or licensing requirements affecting private equity funds investments currently in effect or under consideration by regulators?

Except for investments in regulated companies, there are no special disclosure requirements to be done before the government authorities in private equity investments.

Decree 2,555, as amended by Decree 1,242, establishes that there is no prior authorisation required to set up a PEF. However, prior to initiating operations, the management company must send to the SFC the offering memorandum together with additional information. The SFC has established a licensing process whereby this entity reviews the offering memorandum and makes comments to it. Until all changes and comments made by the SFC are made, the SFC does not issue a registration number that allows the management company to establish the channel for the reporting requirements to the SFC and register the fund with the tax authorities. In other words, through this process the SFC has established a prior authorisation requirement.

21. Please describe any restrictions, requirements or protections applicable to foreign investors in connection with private equity investments.

The general principles and framework that govern Colombia’s foreign exchange regime were established by Law 9 of 1991. Based on the principles and functions established in Law 9 of 1991, the Board of Directors of the Central Bank of Colombia enacted External Resolution 8 of 2000 and its amendments, and later Decree 1,068, 2015, amended by Decree 119 of 2017, which was incorporated on Decree 1,068, compiled the main set of provisions governing

international investments which cover both foreign investments in Colombia and Colombian investments abroad.

Regarding the foreign exchange regime, two markets are contemplated: (i) the regulated market; and (ii) the free market. In the regulated market all operations are subject to the filing of different forms and must be reported to the Central Bank, while those operations that belong to the free market are not subject to these requirements.

Foreign investors must channel through the Colombian foreign exchange market all foreign currency to be used in order to perform their investments in Colombian territory. Foreign currency may be channelled through the foreign exchange market by either (a) authorized intermediaries or (b) compensation accounts, which are bank accounts opened by a Colombian resident abroad that are registered as compensation accounts before the Colombian Central Bank.

The party performing a foreign exchange operation must report such operation to the Central Bank in order to comply with foreign exchange regulations. With the filing of the corresponding form, each operation is reported to the Central Bank and serves the purpose of complying with foreign exchange regulations. In addition it creates the ability, when necessary, to access the foreign exchange market to obtain or sell the necessary foreign currency to comply with its foreign exchange obligations.

In essence, Colombian law, as a general rule, does not set forth foreign exchange restrictions, but rather a set of rules that must be complied with for purposes of obtaining clear foreign exchange rights. Except for investments related to Defense and National Security and toxic wastes, all other sectors may receive foreign investment.

According to Law 9, 1991 and Decree 1,068, 2015 the foreign exchange rights resulting from a registered foreign investment are the following: (i) remitting abroad proven net profits periodically generated by the investments; (ii) reinvesting the profits or retaining as surplus any undistributed profits with remittance rights; (iii) capitalizing any amounts bearing remittance rights, generated by investment-related obligations; (iv) remitting abroad any amounts obtained from selling the investment in Colombia, or from liquidating the company or its portfolio, or from a capital reduction. In addition, pursuant to the same regulations, the conditions for the reimbursement of the investment and the remittance abroad of the profits and revenues that were legally in force at the time in which the investment was registered, may not be changed in such a form that they unfavourably affect foreign investors. Notwithstanding the above, please be advised that this same article establishes as the only situation under which restrictions can be imposed on a temporary basis, the event in which the international reserves administrated by the Central Bank fall below the value of imports for a consecutive 3 month period.

22. Are there any government approvals required in connection with private equity investments in certain industries or any industry-specific regulatory schemes that can affect private equity investments? What are the main requirements to obtain such approvals? Have there been any observable trends recently in the posture of specific regulators or the regulatory environment generally in connection with the review or approval of such investments?

There is no foreign exchange approvals required for purposes of foreign investments in Colombia, except for the registration as described in question 20. The existence of governmental approvals will depend on the industries where the investment is made. In fact, some industries, such as: national defence, toxic waste management, television broadcast, private security companies, and aviation have specific restrictions as per the foreign investment participation. Other types of investments, such as in regulated entities (ie, financial institutions), require a previous governmental authorisation, which makes the requirements of governmental approvals be a case by case matter. Regarding the risks of regulatory approvals, acquisition agreements are structured in a way that such regulatory authorisations are conditions precedent to closing. Without the completion of such conditions, neither party will be bound to close the transaction (except in the case of negligence of the other party). In this case, the parties have no indemnification rights, since the reason for being unable to close depends on a third party – a governmental agency. As a result, neither of the parties has to bear the risk of not obtaining regulatory approval.

23. Please describe any antitrust approvals or other competition law requirements that may apply connection with private equity investments into your jurisdiction?

In Colombia, merger control rules are part of the legal framework of free market competition and antitrust, and are regulated by article 9 of Law 1,340 of 2009 and by Resolution 1,0930 of 2015 which provide as follows:

“Article 9: Merger Control: “Companies dedicated to the same activity or participating in the same value chain within the Colombian territory, shall be obligated to inform the Superintendency of Industry and Commerce (“SIC”) of any operation they might wish to undertake implying the merger, consolidation, acquisition of control or integration; disregarding the legal mechanism used for the proposed transaction, as long as one of the following conditions is met:

- 1. When considered individually or collectively, the parties had during the fiscal year previous to the proposed transaction revenues that exceed the amount that the Superintendency of Industry and Commerce establishes in terms of minimum legal wages, or;*
- 2. At the end of the fiscal year previous to the proposed transaction, the parties had individually or collectively considered assets that exceed the amount that the Superintendency of Industry and Commerce establishes in terms of minimum legal wages.”*

In the event that the parties to the transaction comply with either of the conditions above, but jointly have less than 20% of the relevant market, the proposed operation shall be deemed authorized. In this case, the parties only have to inform the operation to the SIC.

(...).”

According to the above, it is mandatory to inform the SIC prior to the completion of a transaction (i) if both general conditions (presence in Colombia, including horizontal and vertical overlap; and a merger, consolidation, integration, assets purchase agreements or

takeover between the companies) will take place, and (ii) if the joint revenues or joint assets of the parties in Colombia exceed 60,000 minimum legal monthly wages which represents approximately COP\$ 45,000,000,000 (approx. USD\$ 15,000,000).

If the thresholds mentioned above are met and the parties have more than 20% of the relevant market (i.e., a Colombian market in which their activities overlap), the proposed transaction is subject to approval from the SIC. For that purpose, it is necessary to submit a pre-evaluation request, prior to the closure of the transaction and it cannot be closed until the clearance of the competition authority.

In the event that the parties to the transaction meet either of the conditions above, but jointly have a market share of less than 20% of the relevant market, the proposed operation shall be deemed approved by the SIC. In this case, the parties only have to inform the transaction to the SIC, prior to its closing, through a simple notice (*Notificación Simple*).

24. Are there any anti-money laundering or other similar financial regulations that should be considered when structuring a private equity transaction or setting up a vehicle?

As it relates to PEFs, before accepting a commitment from an investor, management companies carry out a full-blown 'know your customer' investigation for anti-money laundering purposes. It is common to structure strategies to control these issues via due diligence and the representations and warranties of the purchase agreement.

The Colombian congress enacted Law 1,778 of 2016 by which measures against foreign bribery are adopted. This law has been regulated by instruments issued by the Colombian Superintendency of Corporations, promoting the use of ethics programmes in companies that fulfil a series of criteria related to size, assets and kind of industry. Other main consequence of this law is that state procurement contracts that are being performed may be declared null and void as result of foreign bribery acts accomplished abroad by contractors even if they have no direct relation with acts performed in Colombia. The effects of this law and its regulation are yet to be ascertained in the M&A arena.

The general rule before was that acquisitions involving a US or UK buyer or a multinational with substantial links to the United States or United Kingdom, were heavily centred on anti-corruption due-diligence and representations and warranties regarding compliance with the Foreign Corrupt Practices Act and the UK Bribery Act. In general terms, such representations and warranties state that the sellers, the target and its directors, officers, employees and agents have not taken any action that violates such anti-corruption statutes (eg, anti-money laundering transactions; illegal political contributions; gifts, bribes and kickbacks to governmental officials, etc), that such persons or entities have not been included on any anti-money laundering or blocked persons lists (eg, the US Treasury Department's Office of Foreign Assets Control's (OFAC) Specially Designated Nationals List), and that such persons or entities have not entered into any transaction with a person or entity that is organised or resident in a country or territory subject to trade sanctions (eg, Cuba, Iran, Sudan and Syria).

In 2016, these kinds of provisions are becoming every time more common also bearing in mind that the local law landscape has changed due to Law 1,778 of 2016. In the case of pure local acquisitions, it is becoming more common to include such types of representations and warranties, making reference to local anti-corruption rules (eg, Law No. 1,474 of 2011). If the

acquisition involves bank financing, it is even more common to see anti-corruption representations and warranties and even specific reference to OFAC and other listings.

25. Are there any exchange controls that typically affect how foreign private equity investments are structured in your jurisdiction?

In essence, Colombian law, as a general rule, does not set forth foreign exchange restrictions, but rather a set of rules that must be complied with for purposes of obtaining clear foreign exchange rights.

In general, all investments made by a non-resident in Colombia are considered to be foreign investments and are made up by direct foreign investments and portfolio investments.

Foreign investors must channel through the Colombian foreign exchange market all foreign currency to be used in order to perform their investments in the Colombian territory. Foreign currency may be channeled through the foreign exchange market by either (a) authorized intermediaries or (b) compensation accounts.

According to Article 58 of External Resolution 8 of 2000 issued by the Board of Directors of the Central Bank, the following are authorized intermediaries: Commercial Banks, Mortgage Banks, Financial Corporations, Commercial Finance Companies, Banco de Comercio Exterior-BANCOLDEX, financial cooperatives and *sociedades de intermediación cambiaria*, are considered as FX Intermediaries, and therefore are allowed to buy and sell foreign currency originated in foreign exchange operations.

When foreign currency is channeled through foreign exchange intermediaries, it is converted into Colombian pesos, at the exchange rate negotiated with such foreign exchange intermediary. In order to register the investment with the Colombian Central Bank, at this same day, an Exchange Declaration for Foreign Investment (previously known as Form 4) will have to be prepared and filed with the foreign exchange intermediary. Other operations such as capitalizations with the distribution of dividends among others must be also reported to the Central Bank.

26. What are the basic tax issues affecting private equity investments in your jurisdiction?

Foreign companies and foreign entities of any nature are subject to income tax and capital gains tax in Colombia, but only with respect to Colombian source income and capital gains, regardless of whether they receive such income and capital gains directly or through branches or permanent establishments in the country.

Dividends paid by a Colombian company to foreign investors are subject to a tax on dividends at a rate of 5 per cent via withholding if such dividends correspond to profits that were subject to income tax in Colombia at the corporate level. On the other hand, if the dividends paid by the Colombian company correspond to profits that were not subject to income tax in Colombia at the corporate level, such dividends are subject to income tax at a rate of 35 per cent plus the tax on dividends at the rate of 5 per cent (the 5 per cent is applied after the withholding of the 35 per cent). These changes will only be applicable on dividends paid out of profits generated as of 2017.

Additionally, the transfer abroad of branch profits or profits obtained through permanent establishments in Colombia is deemed as dividend distributions for income tax purposes. Thus, the transfer abroad of profits obtained through a branch or any other type of permanent establishment would generate an income tax in Colombia (35 per cent) and a tax on dividends (5 per cent) as long as such profits have not been taxed in Colombia at the branch level. If such profits have been taxed in Colombia at the corporate level, the dividends would only be subject to the tax on dividends (5 per cent).

In general, Double Tax Treaties signed by Colombia, establish withholding tax reliefs on dividends. In general, these rates are not applicable to dividends paid out of not taxed profits which are subject to the 35 per cent withholding tax (i.e. such relief are applicable to the 5 per cent tax).

According to new 'thin capitalisation' rules in Colombia, interest expenses will be deductible for income tax purposes, to the extent that they result from debts whose average amount during the fiscal year does not exceed the result of multiplying by three the net worth of the company as of December 31 of the previous year.

As a general rule, capital gains generated in the sale of shares of Colombian companies are subject to income tax at rate of 10 per cent. This rule is applicable if the shares being transferred were held by the seller for two years or more, being such shares fixed assets for the vendor, otherwise, the profit will be subject to income tax at a rate that could be increased up to 40% (year 2017), 37% (year 2018) and 33% as of year 2019.

In a share deal the purchase price should not be lower than the shares' equity value increased in a 15%, unless the seller proves otherwise. This rule is only applicable to shares in Colombian companies not listed in the Colombian stock exchange and does not apply to transactions that are subject to the transfer pricing rules. Note that this rule is also applicable to sale of rights in investment vehicles such as investment funds or PEFs, whose assets correspond to shares in Colombian companies not listed in the Colombian stock exchange.

Colombian companies and Colombian entities are subject to income tax in respect to both, Colombian and non-Colombian source income and capital gains, at a rate of *(i)* 34% in 2017, plus a surcharge of 6% if its taxable base is higher than COP 800,000,000; of *(ii)* 33% in 2018, plus a surcharge of 4% if its taxable base is higher than COP 800,000,000, and of *(iii)* 33% -without a surcharge- for 2019 and the following years. This tax rate is applied on the highest base between the ordinary taxable income and the presumptive taxable income. Tax losses can be carried forward against ordinary taxable income accrued in subsequent taxable years.

Please bear in mind that Law 1,819 of 2016 abolished the tax called income tax for equality (CREE), as of 2017.

Colombia has entered into several double tax treaties (Spain, Chile, Switzerland, Canada, Mexico, France, Czech Republic, India, Portugal, South Korea, Mexico and United Kingdom and North Ireland). However, only the treaty between Colombia and France and UK and North Ireland are not currently in force.

On the other hand, please note that PEFs are not considered as taxpayers for income tax purposes.

PEFs operate as pass-through entities. Accordingly, the income obtained by the PEF, after deducting the expenses (including the fees paid to the local managing company), is distributed to the subscribers or participants under the same title as they were received by the PEF (dividends, interest, capital gains, etc) and under the same tax conditions as if they were received directly by the subscribers or participants.

Consequently, the tax treatment of the participants will depend on two factors: the participant's tax attributes (foreign companies, Colombian residents, Colombian companies, etc); and the nature of the income received through the fund (taxable income, non-taxable income, exempted income, etc).

In addition, PEFs act as income tax withholding agents in relation to the payments made by the fund to their participants or subscribers and to third parties. It is worth taking into consideration the new rule applicable to withholding tax of PEFs mentioned in question 4.

As a general rule, interest income earned by non-Colombian entities, resulting from loans or from financial lease agreements, granted to residents or domiciled entities in Colombia, will be subject to a 15 per cent income tax withholding.

27. What impact are recent and projected changes in macroeconomic trends in your jurisdiction and abroad and your government's reaction to these trends having on private equity activity in your jurisdiction? When did you start to see an impact?

Private equity activity has been constantly increasing in Colombia in recent years owing to the appetite of international, regional and local private equity funds for Colombian assets and the country's wide range of investment opportunities.

Colombia improved in private equity regulations, in part as a reflection of the growing sophistication of regulators and important changes to the pension fund regime.

According to the 2017 - 2018 update of the Latin American Private Equity and Venture Capital Association (LAVCA) Scorecard on the Private Equity and Venture Capital Environment in Latin America, in recent years commitment to the development of a domestic private equity and venture capital industry remains strong, with policymakers and industry practitioners collaborating to form and revise regulations on an ongoing basis. However, the environment for private equity and venture capital has shifted, with decreased fundraising in 2016. At the same time, institutional investors pursuing direct investments such as Canadian pension plans and sovereign wealth funds have significantly increased their investments in Latin America's major markets.

According to the 2017-2018 update of the LAVCA Scorecard on the Private Equity and Venture Capital Environment in Latin America, Colombia (with a score of 64) maintained its fourth place, surpassed by Chile in first place (71), Brazil in second (69) and Mexico in third (67).

In 2016, we saw a good number of private equity deals (by private equity firms and regulated private equity funds) and expect to see more of this type of deal, mainly in the infrastructure, retail, real estate, regulated and unregulated financial services, and energy sectors.

In 2017, we believe private equity activity will be driven, among other things, by a wave of divestment by private equity funds of a number of investments made over the past six years which began in 2015, following the natural maturity of their investments in local assets. Besides, we also expect to see M&A deals involving infrastructure projects to continue.

28. Please describe any other regulations applicable to private equity funds and private equity investments not discussed in your answers to the above questions.

See question 30.

29. Please describe any other recent trends observed in your jurisdiction affecting how private equity transactions are conducted or how these investments are structured.

International standards are increasingly being used for private equity transactions in the Colombian market. Multilaterals and PEFs have been the vehicles that have stepped up to provide financing and channel resources for private equity transactions.

30. Please describe any other relevant legal considerations or new developments related to private equity investments in your jurisdiction not discussed in your answers to the above questions.

Decree 2,103 of 2016, enacted by the Ministry of Finance, increased the investment limits applicable to mandatory pension funds when investing in PEFs which in turn invest in real estate projects.

Finally, the SFC issued new rules in connection with portfolio and participation units' valuations. The main purpose of the valuation is to calculate and disclose to the market the units fair exchange value and the portfolio value. The methodology, periodicity and reporting mechanism are established in the External Circular 100 of 1995 of the SFC.

Partner profiles

Daniel Londoño

He is a partner with more than 15 years of experience member our M&A and finance and capital markets business units. His M&A practice focuses primarily in transactions related with the financial, insurance and broker dealer sectors, where he has advised several national and international clients as buyers or sellers and the government in privatisation process of financial institutions, including the Mercantil Colpatria Group, AIG the Helm Holdings and Royal & SunAlliance Plc.

As a member of the Banking Finance and Capital Markets business unit, Daniel focuses in the structuring and licensing of private equity funds, advising local, international, multilateral institutions credit institutions in financing operations including corporate and project finance transactions, acquisition financings and debt and equity operations in the securities market with particular emphasis in international bond offerings, as well as all type of regulatory approvals within the financial sector for incorporation of all types of regulated entities, M&A transactions, spin-offs, and mergers among others.

Daniel is an attorney from Universidad Javeriana with an LL.M Georgetown University. He has worked at Gómez Pinzón Zuleta since 2005 and before he worked at the IDB and the IIC in Washington DC.

Email: dlondono@gpzlegal.com

Natalia García Arenas

Natalia is partner of GPZ and a member of the M&A and banking and finance teams of the firm with 15 years of experience. She is a lawyer from Pontificia Universidad Javeriana, has a graduate degree in financial law, and an LL.M from Columbia University Law School. Natalia has worked with GPZ since 2002 and she worked as an international associate of Simpson Thacher & Bartlett LLP in New York City.

Email: ngarcia@gpzlegal.com

Firm description

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Authors



Natalia García Arenas

Partner

Corporate / Mergers & Acquisitions

Telephone: (+57-1) 319-2900 Ext. 217.

E-mail: ngarcia@gpzlegal.com

Lawyer with more than 15 years of professional experience and member of the firm since 2002. Her practice focuses primarily in Mergers & Acquisitions and financing transactions. She has counseled local and foreign companies, financial institutions and private equity funds.

Natalia is a lawyer from Pontificia Universidad Javeriana, has a graduate degree in Financial Law from Universidad de los Andes, and an LL.M from Columbia University Law School. In addition, Natalia has worked as an international associate in Simpson Thacher & Bartlett LLP, New York offices.

As a member of the Corporate/Mergers & Acquisitions practice, Natalia has ample experience with local and international sellers and purchasers in connection with the acquisition and sale of companies, including private equity funds, advising her clients throughout these processes which include the legal due diligence of the target companies, the structuring, drafting and negotiation of the transaction documents, filings for regulatory approvals, closing and post-closing matters. The main M&A transactions in which she has actively participate have involved regulated and non-regulated companies from all kind of industries, including among others, the financial and insurance sector, mining and hydrocarbons, thermoelectric power plants, services, retail, agrochemical, pharmaceutical, transport and entertaining.

As a member of the Banking, Finance & Capital Market practice, Natalia has focused her practice in financing transactions, advising Colombian companies and local and international financial institutions. She has ample experience drafting and negotiating financing and security documents.



Felipe Mariño Dueñas

Senior Associate

Corporate / Mergers & Acquisitions

Telephone: (+57-1) 319-2900 Ext. 344

E-mail: fmarino@gpzlegal.com

Felipe Mariño is a member of our Corporate / Mergers & Acquisitions practice and is also part of the infrastructure and real estate areas of the firm. He has more than 11 years of professional experience. Felipe has worked at Gómez-Pinzón Zuleta since 2006, and he also worked, as International Associate, at Simpson Thacher & Bartlett LLP (New York City), between 2012 and 2013 and, as general counsel, at Amarilo S.A.S. (a leading construction company in Colombia), between 2014 and 2016.

Felipe is an attorney from Universidad de los Andes with a specialization in Colombian Corporate Law from Universidad Javeriana and an LL.M from Northwestern University.

Felipe has participated in different M&A transactions in the financial, energy, communications, infrastructure and real estate industries, among others. Felipe has worked with some of the most important economic groups and private equity funds, with presence in Colombia such as Valorem, Mercantil Colpatria, Advent International and Ashmore.

Felipe has also worked, both at Simpson Thacher & Bartlett LLP and Gómez-Pinzón Zuleta, in debt and equity operations in the securities market, including among others, the IPO of AviancaTaca Holding S.A.

Finally, as General Counsel of Amarilo SAS, Felipe led the structuring of the real estate acquisitions, the agreements related to the development and construction of the projects, the licensing and zoning processes, as well as all corporate matters of the company.



Andrés Hoyos

Partner

**Corporate / Mergers & Acquisitions and Banking,
Finance & Capital Markets**

Telephone: (+57-1) 319-2900 Ext. 923

E-mail: ahoyos@gpzlegal.com

His practice is focused on M&A, private equity, joint ventures, financing transactions and securities. Andrés is a partner of the firm with more than 24 years of experience. He 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.

His work for over 10 years at the New York offices of Skadden Arps and Cooley Godward advising local and foreign investors, private equity funds, local and international banks, and local companies and multinationals in a variety of industries in Latin America, provided him with extensive experience to structure and negotiate complex local and cross-border transactions.

Andrés is a lawyer from Universidad de los Andes, received a Diploma from Universidad del Rosario in Capital Markets and has an LL.M. in Comparative Law from the University of Miami.



Paola Ordoñez Arias

Associate

Corporate / Mergers & Acquisitions

Telephone: (571) 3192900 Ext.169

E-mail: pordonez@gpzlegal.com

Paola Ordoñez graduated Cum Laude from Universidad de los Andes. She holds minor degrees in Philosophy and Journalism.

Paola is a member of the mergers and acquisition practice in Gómez-Pinzón Zuleta. Her career began at Posse Herrera Ruíz Abogados, while being a student. Later, she worked at De Vivero & Asociados in state contracts and administrative law affairs.

Currently she is a professor of Contracts at Universidad de los Andes.