



“Change in control under Ecuadorean merger control regulation”



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Ecuador is a jurisdiction with a strict merger control regime, with a short 8 calendar day filing deadline, restrictions on closing prior to obtaining regulatory clearance and severe economic and coercive penalties for gun-jumping. Local law, the Organic Law for the Regulation and Control of Market Power (“LORCPM”), enacted on October 2011, which established the first merger control framework in the country, determines that transactions and agreements where a “*change or taking of control*” exists, are deemed “*concentration agreements*” and may be subject to local merger control, if either of two (a market share, and/or turnover) thresholds are met. Although foreign frameworks generally clarify when and how change of controls are deemed concentrations, and introduce requirement such as the lasting basis of the change in control, or the structural modification of the market, the provisions of the local legal framework do not specifically tend to this limitation. The regulation of these limitations has only been introduced throughout the years of practice by guidance documents and interpretations of the Merger Control Intendancy.

Although exemplary acts are defined by Art. 14 of the LORCPM, including mergers and acquisitions, joint-venture and administration agreements, and the assignment of the effects of a trader, the broad scope of the concept of “*change or taking of control*” may determine that other forms of agreements, and also atypical forms of the aforementioned ones, could be subject to notification in this jurisdiction. These cases merit specific analysis when the economic or market share thresholds are met by the intervening parties. For example, the acquisition of interests in operators with a significant turnover or market share in Ecuador, where these interests confer the acquirer veto and/ or specific voting rights may be deemed to confer the acquirer a control or determinant influence in the operator and require notification and prior approval. Local law does not differentiate between horizontal or vertical concentrations, which led to the head of the Authority to issue an opinion² which clearly included vertical integrations within the scope of control by stating that “*There are no legal provisions or considerations of an economic nature that support that a vertical concentration is outside the scope of subparagraph b) of Article 16 of the Law. In this sense, the commission, under article 16 letter a) of the LORCPM is applicable to horizontal or vertical concentration operations, as there are no legal provisions that allow for an interpretation that excludes or contradicts the conclusions that have been expressed in this consultation*”.

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² Case No. Nro. DS-SCPM-2013-375



Under this context, the analysis of the concept of “*change or taking of control*” is fundamental in determining several aspects of a potential transaction. To begin with, the finding that a transaction effectively generates a “*change or taking of control*” will lead to analysis of thresholds, and determination of the filing requirement. Subsequently, where filing is mandatory, a clear notion of the concept will allow parties to determine what acts are permissible throughout the notification and approval procedure. From this perspective, a clear notion of “*change or taking of control*” facilitates the implementation of measures to protect the acquirer’s interests during the notification procedure, while avoiding incurring in acts, which may expose the acquirer to responsibility. In certain cases, before, or during a merger control notification, parties may consider carve-out structures seeking to isolate of the effects of a multi-jurisdictional transaction in Ecuador. In these cases, avoiding a change or taking of control is fundamental in reducing the risk of a regulator determining that such structure is ineffective or insufficient to limit anticompetitive concerns. A recent decision by the Tribunal of the Administrative Council for Economic Defense (CADE)³ in Brazil reflects this particular regulator’s concerns about contractual carve-outs and their effectiveness, and also the difficulty in monitoring them. Such concerns generate an opportunity to analyze each case and structure and consider more sophisticated structures, which tend to these concerns, for example, through trusts and other measures. If effective alternatives are viable, these may allow closing of global transactions while isolating the local leg of a transaction while approval is pending, in exceptional cases. All these perspectives clearly show that avoiding a change in control is fundamental in reducing the exposure to liability for gun-jumping, which in Ecuador is subject to severe penalties of up to 12% of the annual local turnover of the parties, and even the potential unwinding of the transaction in Ecuador.

Hence, the concept of “*change or taking of control*”, should be analyzed in the context of the general notions of the LORCPM, as well as case law and analysis performed by the regulator in its decisions and studies. As a starting point, Art. 14 of the LORCPM includes, within the description of the acquisition of shares, a limitation that these should grant the acquiring entity “**control of, or substantial influence**”. The same article, within its broad definition of economic concentration, considers “*any other agreement or act which transfers the assets of an economic operator in a factual or legal way to an economic person or group, or gives them decisive control or influence in decisions regarding ordinary or extraordinary administration of an economic operator.*” These articles are a starting point that reflects that local law requires that the change or taking of control should allow for “**substantial**” or “**determinant**” influence in the decisions of the other. Generally said, an acquirer should acquire control when it can decide on strategic matters, such as such as budget approval, commercial strategies, business plans, new investments, or appointment of senior executives of the company, or when it can block decisions like those mentioned before. The broad scope of local law also creates scenarios where change or taking of control can occur, irrespective of the interest being acquired (e.g 51% or 20%), if such interest grants the acquirer a substantial or determinant influence. Thus, a minority interest, accompanied by statutory or contractual provisions may be deemed a concentration under local law. These possibilities reflect the obligation to perform analysis of the specific rights granted to the parties both contractually, and through the by-laws of the entity in question, where a minority interest for example, can grant the acquirer certain veto or voting rights, which may significantly impact the ordinary or extraordinary administration of an economic operator.

The broad scope of the LORCPM and the concept of concentration, the lack of experience of operators and the regulator with a merger control framework, tied to the high risk of exposure to fines led several notifications or consultations being addressed to the Authority. This led to the concepts of change or taking of control, substantial or determinant influence being subject to analysis by the Authority, in several notified transactions, including intra-group reorganizations which

³ <http://en.cade.gov.br/press-releases/cisco-and-technicolor-admit-practice-of-gun-jumping-in-global-transaction-1>



are not formally excluded by the governing framework, and have only been clarified through precedents of the Authority.

The first traces of the concept being generally mentioned or explored by the Authority can be found in early cases, such as:

1. **SCPM-DS-CP-001-2013**⁴, the authority established that the fundamental requirement for a concentration to exist is *“the existence of a change or taking of control, legally, or factually, between the involved operators”*.
2. **SCPM-ICC-2013-0086**, the Authority considered that *“This dependency has been able to establish that the merger through absorption notified by the economic operator GINSBERG ECUADOR S.A., DOES NOT COMPLY with what is provided in article 14, first paragraph of the Organic Law of Regulation and Control of the power of the Market that expresses “for the purposes of this Law it is understood economic concentration to change or take control of one or more companies or economic operators “(...) because there is no change or effective takeover. Reason why an ECONOMIC CONCENTRATION OPERATION IS NOT CONSIDERED according to what is stipulated in the Law.”*
3. **SCPM-ICC-2013-0302-O** the Authority considered that *“from the documents provided by the National Council of Civil Aviation and Aerovías del Continente S.A. AVIANCA, which are included in the file No. SCPM-ICC-0014-EXP, the operation in question consists of unification of the brand of the companies that belong to the Avianca group. In other words “Avianca Group companies have decided to unify their brand, in such a way that the only brand and commercial name that will be used in the future is “Avianca” (...) With this background, this Authority concludes that the operation carried out between AVIANCA S.A., (Holding) and its integrated companies (...) does not fall within the scope of application of article 14, first paragraph of the LORCPM, because there is no change or effective taking of control in accordance with the parameters established in the Law Organic Regulation and Control of Market Power collected in report SCPMICC-2013-0028-1”*.
4. **SCPM-ICC-EXP-0005**, the Authority concluded that *“the operational integration operation of the companies that will continue to act through the company name DIFARE S.A., and that currently belong to the holding group DIFARE CIA LTDA., and in such reason there is no change or take of any control as provided in the first paragraph of Article 14 of the Organic Law of regulation and control of market power.”*

In a re-organization of public entities in the crude oil extraction and production sector, Petroamazonas and Petroecuador, led to report No. SCPM-ICC-2013-008-I⁵, where the Authority examined intra-group operations and evaluated the concept of control through a comparative study between similar legislations. In such case the Authority formally concluded that *“intra-group operations are not considered economic concentration operations, as they entail the distribution of assets or values between companies of a same group, and there is no third-party intervening in the operation, meaning that a change or taking of control does not exist, as defined by the framework and theory”*. In light of the series of mandatory notifications, informative notifications, and consultations evidencing a lack of clarity of the framework, the Authority issued a legal-economic interpretation of the change or taking of control in the Ecuadorian merger control regime in September 2015 and technical guidance document for merger control in December 2013⁶.

⁴ Prior consultation SCPM-ICC-CP-001. Frutera del Litoral Cia. Ltda and Agrícola Pura Vida S.A. Agrupvida of October 9, 2013

⁵ <https://es.scribd.com/document/196548215/Informe-Operacion-de-Concentracion-SCPM-Ecuador>

⁶ <http://www.scpm.gob.ec/es/site-map/articles/93-control-concentraciones/517-guia-tecnica-analisis-operaciones-concentracion-economica>



The first document finally provides greater certainty on the subject, by established the “*prior independence*”, “*structural reform*”, and “*lasting basis*” criteria. These clarifications derive from an analysis of the Monetary Financial Code, whose article 192 stated that “*It is understood that control over a legal entity, is held by persons who by themselves or in conjunction with others, with whom there is a joint action agreement, have the power to to influence in a decisive way in the decisions of her; or that are capable of ensuring the majority of votes in the shareholders' meetings and can elect the majority of directors or administrators. It is considered that there is joint action agreement, when two or more people hold an agreement, express or implied, to participate with similar interest in the management of society or to control it.*” The document also references international accounting norm (NIC 27) which states that “*It will be presumed that there is control when the dominant possesses, direct or indirectly through other dependents, more than half the power of vote of another entity, unless there are exceptional circumstances in the that can clearly demonstrate that such possession does not constitute control*”. In a comparative analysis of European rules, and those of the Chilean competition Authority, the local merger control intendancy introduced the “*previous independence*” principle by establishing that “*This definition establishes that a concentration will occur when two companies previously economically independent, through a contractual arrangement or factual, align their incentives to jointly maximize their benefits through of decision making or joint action.*”, and also the “*structural change*” definition in saying that “*economic concentration operations subject to analysis by the concentration regime are all those that can generate a structural change in the market resulting from the reduction of an independent competitor*”. Finally the Authority states, “*comparative legislation tells us that in order for a concentration to affect the market, it is necessary that you first configure a lasting control by the operators to concentrate. If there is no such control, the concentration regime should not be applied in terms of competition.*”

All of the aforementioned lead us to conclude that local merger control also adheres to the international tendency that change in control should derive from a situation of previous independence, cause a structural reform of the market, and give the entity in question control on a lasting basis, in order for a concentration to exist in Ecuador. This conclusion also provides clarity into what kinds of actions taken by parties during a notification can derive in contingencies for gun-jumping, and which of these can remain outside of the definition of change of control and can be implemented by parties without affecting the ex ante control of the local Authority.