

# LATIN AMERICAN

## Law & Business Report



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### HIGHLIGHTS

#### Smart Exit Strategies for LatAm Private Equity Investors

There is renewed interest in private equity investing in Latin America, after what has been, for many investors, quite a rocky ride. There is much to be learned from past mistakes, and none is more important than a well planned—and feasible—exit strategy, particularly when the investment is a family business. A review of practical and legal considerations. **Page 3**

#### Discounting Brazilian Naysayers

Company managers in Brazil say sales are robust, even as Brazilian press outlets report that high interest rates are choking the boom. Who is correct? There are good reasons to believe the managers. Newly created jobs, more available credit, increases in capital equipment, low inflation and other factors all point to healthy growth. **Page 5**

#### Perils of Board Membership in Argentina

Argentine courts generally presume a director is responsible for company problems in the absence of proof to the contrary. **Page 7**

#### New Law Creates Opportunities for Investors in Brazilian Roads, Power and Ports

By channeling revenues into special trust funds, the Brazilian Public-Private Partnership law reduces risks for private investors. A review of improvements brought by the law, as well as potential hazards to investors that the law failed to address. **Page 12**

#### Price Liberation in Chile's Electricity Sector to Bring New Investments

Chile's new electricity law promises to spur badly needed investment in new power plants by freeing up restrictions on price increases. **Page 22**

#### Buyer Beware of Polluted Land in Mexico

A new rule has gone into effect that will permit the Mexican environmental authorities to strengthen enforcement of pollution laws that regulate oil, gas and other hydrocarbon pollution in soil. Questions remain over successor liability for cleanups. **Page 24**

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## Capital Formation in Latin America and the Caribbean

by Marc Ricart and Wei-Ling Chang (*BG Consulting*)

[Editor's Note: This second of a three-part series examines ways to raise financing for companies operating in Latin America. Part one (*LALBR*, April 30, 2005, p. 3) examined loans and equity financing from multilateral organizations such as the International Finance Corporation and the Inter-American Development Bank. This second part focuses on OPIC financing to Latin America.]

### Overseas Private Investment Corporation

The Overseas Private Investment Corporation (OPIC) is an agency of the U.S. government charged with promoting U.S. private investment in developing countries. OPIC helps U.S. businesses, and foreign companies with a U.S. interest, invest overseas, fosters economic development in new and emerging markets, complements the private sector in managing risks associated with foreign direct investment, and supports U.S. foreign policy. In 2005, OPIC is expected to underwrite \$2 billion under its political risk insurance and expects to finance up to \$726 million in multiple projects.

Latin America/Caribbean is OPIC's largest regional destination with around 35 percent of its portfolio allocated to this region. Specifically, South America is the largest region receiving 27 percent or \$3.7 billion of OPIC's combined portfolio as of September '04. Brazil, Venezuela, Argentina and Colombia are the region's biggest recipients. As of March '04, OPIC's biggest exposure in Latin America was in the power sector, followed by oil and gas and financial services with a 26, 21 and 16 percent share. Following are the communications and transportation sectors with 9 and 8 percent shares.

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OPIC supports, insures and finances new investments, privatizations, and expansions and modernizations of existing plants with substantial U.S. participation that are financially sound, promise significant benefits to the social and economic development of the host country, and foster private initiative and competition. It evaluates all project applications on the basis of their contribution to economic development to ensure successful implementation of the organization's core developmental mission, and prioritizes the allocation

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***A subsidiary of a Minnesota company recently was awarded a \$3.3 million loan for a wastewater treatment plant in Chihuahua state in Mexico.***

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of scarce resources to projects on the basis of their developmental benefits. Generally, for new projects, OPIC will consider providing financing of up to 50 percent of the total project costs up to a limit of \$250 million per project. Also, as a general guideline, OPIC looks for at least 25 percent of the project equity to be held by qualified U.S. entities (though this "participation" can sometimes be satisfied by means other than an equity share in the company—such as long term technical assistance contracts with U.S. consulting firms).

Once the contact has been made with an OPIC officer, and a preliminary proposal with basic information on the case has been submitted, OPIC will send a letter of acknowledgment and intent to the corresponding parties and the company will be informed that contingent upon completion of a feasibility study and of a detailed business plan of the prospective project; OPIC will consider the company's request for financing. Such considerations would be subject to OPIC's comprehensive project review process which includes confirmation of the viability of the project and approval by OPIC's management as well as approval by relevant local government authorities.

Confirmation of the viability of the project requires, among other criteria, evidence satisfactory to OPIC, that: 1) sponsors have a successful track record; 2) the project has a proper capital structure; 3) sponsors have the credit quality to make the required equity investment and project completion guaranties; 4) project completion risks are adequately covered including both physical and operational completion; 5) project owners and managers have adequate experience with the operation and management of the technology to be utilized; 6) the technology to be used is adequately proven; 7) the project meets World Bank,

*Capital Formation, Continued on page 26*

## Capital Formation (from page 25)

host country and other applicable environmental guidelines; and 8) the project meets OPIC's workers' rights and other policy criteria.

From the initial contact with an OPIC officer, a project might take three to four months to be approved; the disbursement of funds may take up to six months.

OPIC offers three basic types of products: Political Risk Insurance, Financings of Investment Funds and Direct Loans. Under direct loans OPIC provides loans to companies through third party guarantees and also directly should the client fall under the small and medium enterprise eligibility criteria.

### OPIC Financing—Loans

OPIC financing provides medium-to-long term funding through direct loans (Small and Medium Enterprise and Small Business Center Programs) and loan guaranties (where funds are lent through third party financial institutions) eligible ventures in the

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### *Latin America receives the most OPIC funding of any region.*

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markets where conventional financial institutions often are reluctant or unable to lend on such a basis.

In addition to the eligibility requirements mentioned above, OPIC financings must be commercially and financially sound. They must be within the demonstrated competence of the proposed management, which must have a proven record of success in the same, or a closely related business, as well as a significant continuing financial risk in the enterprise (substantial equity participation). Moreover, more than 50 percent of the voting shares of the overseas venture should be held by firms or persons from the private sector. OPIC most often finances companies with a sound debt-equity ratio that will not jeopardize the project through excessive leverage (debt-to-equity ratio should be in the range of 60/40).

### *Small and Medium Enterprise (SME) and Small Business Center Programs (SBC)*

OPIC's SME financing assists small and mid-market companies in developing their overseas businesses. In order to qualify to use OPIC's SME financing, the project sponsor may not have had more than \$250 million in revenues in the last fiscal year if the sponsor is a corporation. If the sponsor is other than a corporation, the net worth of the entity may not have exceeded \$67 million in the preceding year.

The Small Business Center, which rests under the SME financing unit, offers qualified small businesses

the opportunity to utilize OPIC's resources with improved customer service, flexible coverage and easier access through a streamlined approval process. In order to qualify to use OPIC's Small Business Center for financing, the project sponsor may not have had more than \$35 million in revenues in the last fiscal year if the sponsor is a corporation and if it is other than a corporation, the net worth of the entity may not have exceeded \$27 million.

OPIC loans under the SBC programs for overseas investments range from \$100,000 to \$10 million with terms from three to 15 years. Interest rates are capped at 7 percent above the Direct Loan Discount Rate which is set by the U.S. Treasury. In addition, there may be a one-time facility fee of up to 2 percent and an annual maintenance fee not to exceed 1 percent of the outstanding balance of the loan. While the eligible U.S. small business must own at least 25 percent of the overseas project, OPIC may be able to finance up to 65 percent of the total project costs.

An example of an OPIC financed project is a loan extended to a small business used to construct a wastewater treatment facility in a city in northern Mexico, providing important support to its agricultural sector and relief from a 12-year drought. OPIC provided a \$3.3 million loan to Lemna de Mexico, a subsidiary of Minnesota-based Lemna Corporation, for the construction of a wastewater treatment facility in Cuauhtemoc in Chihuahua State. The plant is currently under construction and due to be completed in July 2005. The "U.S. nexus" was the equity participation in the Mexican corporation by its U.S. parent company.

In another example, OPIC approved a \$50 million loan guaranty that permitted an American company to expand a wireless telecommunications network in Bolivia. NuevaTel, the Bolivian subsidiary of Washington-based Western Wireless Corporation and its affiliate Western Wireless International, used the OPIC guaranty to expand their network and to replace interim short term equipment financing with permanent long-term debt. The project helped NuevaTel offer

*Capital Formation, Continued on page 27*

### **Establishing the "U.S. Connection"**

Financing by OPIC is similar in many ways to equity and debt financing offered by the Inter-American Development Bank and other multilateral financing agencies. There is one big difference, however. As a prerequisite to getting financed from OPIC, the recipient company must establish a nexus between the project in Latin America, and the U.S. While this restriction sometimes sounds difficult to meet, companies have several alternative options to satisfying this requirement.

## Capital Formation (from page 26)

more services to more customers and to improve coverage of its GSM network. Cooperativa de Telecomunicaciones Cochabamba Limitada, one of Bolivia's largest telecom cooperatives, was the minority shareholder in NuevaTel.

### **OPIC Political Risk Insurance**

OPIC Political Risk Insurance provides security for business to pursue opportunities in emerging markets where the rules of the game can change drastically and suddenly. OPIC insurance helps cover three political risks: currency inconvertibility (i.e., host country payment cannot be converted into hard currency), expropriation, and political violence.

OPIC can insure up to \$250 million per project, up to \$300 million for projects in the oil and gas sector with offshore, hard currency revenues, and up to up to \$400 million if the project receives a credit evaluation.

OPIC insurance is available to U.S. citizens, corporations, partnerships or other associations created under the laws of the United States, its states or territories, and beneficially owned by U.S. citizens, foreign corporations, that are more than 95 percent owned by investors eligible under the afore-mentioned criteria; and other foreign entities that are 100 percent U.S.-owned. Sometimes even lesser U.S. equity participation (50 percent) has also been acceptable.

Investors are required to register projects with OPIC before the investment has been made or irrevocably committed.

### **Investment Funds**

To address the lack of sufficient equity funds in certain regions or sectors in emerging market economies OPIC has supported creation of privately-owned, privately-managed investment funds that make direct equity and equity-related investments in new, expanding or privatizing companies. By providing long-term growth capital and facilitating critically needed technology and management skills development, these funds act as a catalyst for private sector economic activity in the developing countries served.

Along with OPIC's insurance and project finance activities, these investment funds serve to carry out OPIC's mission to mobilize and facilitate participation of U.S. private capital and skills in the economic and social development of less developed countries. Specifically the funds contribute to:

- support for the achievement of U.S. foreign policy objectives, such as promoting political and economic stability in emerging democracies

through development of the private sector and privatization of state-owned businesses, and promoting U.S. practices in business, the environment, and worker rights;

- development of new markets and opportunities for American companies, facilitating early access to new consumers and improving competitiveness in the developing world; and
- strengthening economic growth at home through connections that may be established between U.S. companies and the businesses supported overseas, such as joint ventures, franchising, supply or distribution arrangements.

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### ***In Latin America, most of OPIC financing went to projects in the oil & gas and financial services sectors.***

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OPIC supports only those investment funds specifically limited in scope to regions or sectors that have been identified by OPIC as having particular needs for equity funding not being met by the private sector. The decision to support a fund is highly selective, and is made at the discretion of the agency. In general, funds are organized by experienced sponsors of previous investment vehicles who raise the funds' equity capital through private placement of equity interests with sophisticated institutional, corporate, and other qualified investors. OPIC supplements private equity capital by lending or guaranteeing long-term debt (typically with a 10 to 12 year maturity) to a fund. OPIC's new program standard limits the amount of debt to one-third of the private equity capital invested in the fund, and the debt will be unsecured. OPIC receives commercially-based fees and profit participation as compensation for the financing provided to the fund, and the program is structured to ensure that fees and profit participation will fully cover costs. Eligibility requirements remain the same as for other OPIC products. OPIC does not offer any guarantee of the fund's equity, and all equity investments in OPIC-supported funds are fully at risk, and subordinate to any OPIC lending or guaranteed debt.

OPIC has invested \$800 million in Latin America over the course of its funds investment program, with \$250 million of that invested in four funds in 2004 and early 2005.

While any company that complies with any of the above organization's requirements can approach the institutions individually, outside firms can be hired to intermediate with the elaboration and submittal of documents and investment proposals. □

## VENEZUELA

### First Phase (from page 31)

Venezuela—all interested in participating in the selection process for the granting of the non associated gas licenses.

#### Terms

The duration of the licenses to be granted by the Ministry of Energy and Petroleum for the first phase of the Rafael Urdaneta Project is 25 years and the State may participate through PDVSA, having a percentage of up to 35 percent, once the marketability of the blocks is declared. The gas found will be used primarily to satisfy the domestic market demand, which displays a deficit of 1,500 million cubic feet per day.

#### Deadlines

Interested companies must submit in June the financial guarantees that PDVSA requires for these operations, upon prior purchase of the data pack which will cost \$250,000. Bids must be delivered in July, the

winners will be announced in August and licenses will be delivered in September and the second phase of the bid process will begin. This process includes the surrender of four additional blocks. Two other phases will follow to complete the 29 blocks of the project. The entire bid process will end in 2007.

Under the Organic Hydrocarbons Law, PDVSA may form Mixed Operating Companies with the gas license operators that find petroleum in these blocks. In this case, the companies will have a maximum period of six months to submit a proposal for the exploitation of reservoirs that will be approved by the Ministry of Energy and Petroleum.

This project, which would require an estimated total investment of 20 billion dollars, is included in the National Gas Plan, under which licenses have been granted to explore and produce gas onshore and in the Plataforma Deltana area. All of the projects that make up the national plan are subject to the Organic Law of Gaseous Hydrocarbons, the provisions of which allow for 100 percent private participation and include a royalty scheme of 20 percent and a tax disbursement of 34 percent. □

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