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Fourth Edition

Editor
Simon Robinson

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EDITOR'S PREFACE

In response to the financial crisis, the past year has been spent cutting costs and restoring balance sheets while governments have set about overhauling the regulatory landscape. Whether as a result of this approach or in spite of it, we have seen the first signs of a recovery in the second half of 2009. During the financial meltdown, many strong businesses focused on assessing their strategy and restructuring. As the signs of recovery began to emerge, such businesses tentatively started to re-engage in M&A transactions as a means of achieving growth.

Currently, buyers are conscious of scrutiny from shareholders with regards to how much is being paid for assets and whether the deals that are going ahead represent value for money (particularly in light of Warren Buffett's publicly voiced concerns during the course of Kraft's bid for Cadbury and shareholder reaction to the proposed acquisition of part of AIG by Prudential). Consequently, most potential buyers are treading carefully. On the other hand, there were also a number of quick deals in 2009 where a speedy resolution was necessary to allow distressed sellers to obtain cash promptly but the number of these should decrease throughout 2010 if we continue through to recovery.

Many are still cautious about the outlook for M&A activity for the remainder of 2010 and beyond. A rise in M&A activity is hugely dependent on the willingness of banks to increase lending. Access to credit plays a vital role in supporting the economy by helping businesses to create jobs and growth, both of which are necessary if we are to find our way out of recession and towards recovery. In the short term, M&A activity will depend heavily on boardroom confidence and such confidence will only be achieved if boards perceive that the few new M&A deals around have proven profitable for shareholders. Such confidence and optimism is slow to build; therefore, while pockets of activity suggest that the worst of the financial crisis is behind us, the signs of recovery are tentative with buyers urging caution. The journey to recovery will be slow and difficult, but as lending increases and confidence rises, economists expect the sluggish growth of 2010 to develop into greater stability into 2011. That said, the recent problems of the euro, European government finances and the European banking sector could yet bring a renewed lapse into recession or worse. Only time will tell which progression turns out to be correct.

I wish again to thank all the contributors for their continued support in producing this book – one would hope that in this uncertain time the following chapters should at least provide some food for thought.

Simon Robinson
Slaughter and May
London
July 2010

Chapter 44

PANAMA

Eduardo de Alba and Julianne Canavaggio[*]

I OVERVIEW OF RECENT M&A ACTIVITY

Despite the international financial crisis having a moderately negative impact in Panama in 2007–08, M&A activity is staging an explosive recovery in 2009–10. The Panamanian economy has experienced periods of unprecedented growth with a noteworthy increase in the establishment of foreign businesses and investors looking for opportunities. The expansion of the Panama Canal at a cost of approximately $5.25 billion, and the metropolitan transportation system, are only two of a series of mega-infrastructure projects in the works that are contributing to this positive increase. Additionally, Panama has enacted a law that grants tax, immigration and labour and employment benefits to multinationals who establish regional offices or headquarters, in Panama. Companies such as Procter & Gamble, Caterpillar, AES, Halliburton, LG, Hewlett-Packard, Maersk, Roche, Hyundai, Peugeot/Citroën, Pan-American Life Insurance Company, Western Union and 3M are some of the multinationals who have taken advantage of this new law, and established regional offices or headquarters in Panama. The country is experiencing consistent economic growth, with a real GDP growth rate in 2008 of approximately 8 per cent, 2.5 per cent in 2009 and for 2010 it is expected that the growth rate will be around 4.5 per cent.

II GENERAL INTRODUCTION TO THE LEGAL FRAMEWORK FOR M&A

The relevant Panamanian laws and regulations governing business combinations include Law No. 32 of 1927 ('the Corporations Law'), Law No. 4 of 2009 ('the Limited Liability Company Law') and the Commercial Code, which is supplemented by the Civil Code. As

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combinations generally cause taxable events, the Tax Code and its regulations (especially Executive Decree 18 of 1994, which establishes a special regime regarding stock-for-stock mergers) and Law No. 18 of 2006, which created a special capital gains regime are also relevant. In the case of publicly traded companies, Decree Law No. 1 of 1998 and its regulations ('the Securities Law') govern tender offers, proxy statements and rules of disclosure, among other matters.

Business combinations in Panama are usually structured as stock or asset purchases, tender offers or mergers, but other techniques are also used, such as the capitalisation of stock of two operating companies to a holding company especially incorporated for that purpose and the joint participation in the holding company. In the case of publicly traded companies, combinations usually take place through a two-step process that starts with a tender offer (either for stock or cash or a combination of both) followed by an actual merger. Several recent bank mergers have followed this format.

III DEVELOPMENTS IN CORPORATE AND TAKEOVER LAW AND THEIR IMPACT

In recent years there have been changes in the tax regime applicable to capital gains and dividend tax, the enactment of a new competition law, and a new law regulating limited liability companies. The impact of these developments is discussed *infra*.

IV FOREIGN INVOLVEMENT IN M&A TRANSACTIONS

The globalisation of markets and free-trade alliances has resulted in a general increase in the past few years in cross-border M&A activity. In almost all of the more recent M&A transactions in Panama, local companies have been the targets of foreign and multinational corporations. Political instability in nearby Latin American countries, especially Venezuela, Argentina, and Ecuador, has also been a substantial driver for inbound investments into Panama, as individuals and companies seek to diversify their country risk.

V SIGNIFICANT TRANSACTIONS, KEY TRENDS AND HOT INDUSTRIES

Notwithstanding the global financial crisis, recent years have seen periods of unprecedented growth in the Panamanian economy with a noteworthy increase in the establishment of foreign businesses and investors looking for opportunities. As previously mentioned, major multinational companies such as Procter & Gamble, Caterpillar, AES, Halliburton, LG, Hewlett-Packard, Maersk, Roche, Hyundai, Peugeot/Citroën, Pan-American Life Insurance Company, Western Union and 3M among others, have taken advantage of legal incentives in the areas of tax, immigration and labour and employment, enacted specifically to benefit multinationals who establish regional offices or headquarters in Panama. Members of the consortium that was awarded the $3.2 billion contract to design and build the Panama Canal's new set of locks are establishing substantial operations or expanding their existing operations in Panama. This consortium includes Sacyr Vallehermoso SA (leader, Spain), Impregilo SpA (Italy), Jan de Nul NV (Belgium), Constructora Urbana, SA (Panama), design subcontractors Montgomery Watson Harza (leader, United States), IV-Groep (Holland), Tetra Tech (United States), and gate manufacturing subcontractor Heerema Fabrication Group (Holland).

During recent years, most important sectors of the Panamanian economy have been subject to cross-border acquisitions. The banking sector, which is Panama's stronghold, saw the sale of a significant portion of the BNP Paribas commercial and retail banking operations of its Panama branch to the Bank of Nova Scotia, Panama branch, and the reorganisation and purchase of Stanford Bank, which was the first banking reorganisation to ever be carried out in Panama. In the recent past we also saw the stock merger between Bank of America Corporation and Merrill Lynch & Co Inc Merrill Lynch had one of its largest and most active Latin America operations in Panama and it also operated an international licensed bank in Panama. In the insurance and reinsurance business, Mapfre America SA, a Spain-based global insurer, acquired 57 per cent of the shares of Aseguradora Mundial SA, Mundial Desarrollo de Negocio SA and their respective subsidiaries from Grupo Mundial Tenedora SA, followed by a contribution of the shares by both parties into a holding company in a strategic alliance to develop Central America's largest insurance company. Mapfre also contributed the shares of its El Salvador operations (INAMER and Mapfre La Centroamericana) into the holding company, resulting in a 65 per cent shareholding by Mapfre and 35 per cent by Grupo Mundial. The entire deal was valued at approximately $211 million dollars. The resulting venture brought together Mapfre's El Salvador operations with Grupo Mundial's operations in Panama, Costa Rica, Nicaragua, Honduras and Guatemala, resulting in the largest insurer in Central America, with combined premiums of $223 million and equity of $101 million. The insurance and reinsurance industry also saw the acquisition of Aseguradora Ancón by Venezuelan-owned Multinacional de Seguros for an undisclosed amount.

In the natural resources sector, Panama was one of several countries involved in the acquisition by SIBUR, Russia's leading petrochemical company, of Citco Waren-Handelsgesellschaft GmbH, a leading international petrochemical trader and parent company of Westin Trading SA, a company organised and existing under the laws of Panama. Rio Tinto Brasil Ltda sold its undeveloped potash assets, largely comprising the Potasio Rio Colorado (PRC) potash project in Argentina, and its Corumbá iron ore mine in Brazil and the associated river logistics operations in Paraguay to Companhia Vale do Rio Doce, the Brazilian mining company, for a total cash consideration of $1.6 billion, through Panamanian holding companies. Another substantial transaction in this area was the indirect acquisition by Prime Natural Resources, Inc, a subsidiary of True North Energy Corporation, of a substantial palm oil plantation business in Colombia. Panama was one of several countries involved in the acquisition by Eurasian Natural Resources Corporation plc (a London Stock Exchange-listed holding company of a leading diversified natural resources group with integrated mining, processing, energy and logistical operations based in Kazakhstan) of a 50 per cent interest in Bahia Mineração Limitada ('BML'), a Brazilian company focused on the development of an iron ore deposit in the Bahia State of Brazil. The 50 per cent interest in BML was acquired from Zamin BM NV for a cash consideration of $300 million.

In industrial services, Harsco Corporation acquired ESCO Interamerica Ltd, one of Latin America's premier engineering and equipment services providers to the infrastructure sector; we also saw the sale by Empresas Hopsa SA of a majority interest in Mortero Seco Panama SA, a pre-mixed dry mortar plant, to local and regional investors.

In the telecommunications industry, Medcom Holdings Inc merged its indirect subsidiary Cable Onda SA with Telecarrier Inc Cable Onda is the dominant player in the Panamanian market for pay-TV services. It also provides broadband internet and telephone services primarily to the residential market. Telecarrier is a provider of broadband internet and telephone services primarily to the business market, as well as various telecommunications solutions such as a datacentre, routers and security administration and private networks to international carriers. This merger resulted in the only 100 per cent Panamanian-owned telecommunications services provider of pay-TV, telephone, broadband internet and telecoms-affiliated services.

In the food and beverage industry, we saw the acquisition of a new operation by Colombia's Casa Luker. In 2005, Casa Luker acquired Pascual, the leading local biscuit and sweet factory, and in 2008, through the Pascual subsidiary, Casa Luker acquired the pasta-manufacturing facilities of La Suprema. In 2008, Costa Rica's Cooperativa de Productores de Leche Dos Pinos, an important player in the Central American milk industry, merged with Cooperativa de Leche de Panamá ('Cooleche'), with Cooperativa de Productos Lácteos SA (Coopralac) emerging as a result of the merger, 51 per cent owned by Dos Pinos and 49 per cent owned by Cooleche.

In the services industry, Irish online recruiter Saon Group acquired the Panamanian holding company of Tecoloco International Inc, a Central American online recruiting company, which also has a significant operation in Panama. Saon Group has operations in 16 countries through 45 companies, and this acquisition enabled Saon Group, who has experience in the 'dot-com' recruiting market, to establish operations in Central America.

Other important deals have included information and communications technology service company Elandia International Inc's acquisition of CTT Center of Technology, a pioneer in providing talent development and technical certifications for industry leaders, including Cisco, Microsoft and Google, throughout Latin America, which acquisition will create the largest regionally integrated provider of IT training in Latin America, and Apollo Management LP's acquisition of the operations of Regent Seven Seas Cruises. The acquisition was carried out through Prestige Cruise Holdings Inc, an Apollo subsidiary, under which the operations of Regent Seven Seas Cruises and Oceania Cruises (which was acquired in 2007) were placed.

In recent years, M&A deals in Panama have had many drivers. Certain deals have been instigated by the need to consolidate in a very competitive environment, particularly in the banking and telecommunications industries; others have been concluded to control costs and exploit synergies, while others have been fuelled by the global economy and the need to develop new international markets and expand market share. Additionally, some of the most important transactions in the Central America region have included a Panamanian target, whether it be an operating company or a holding company registered in Panama with operations in the region.

VI FINANCING OF M&A: MAIN SOURCES AND DEVELOPMENTS

M&A financing in Panama is done by local and international banks, as there are no limitations in Panama on international lending, and also from local and international securities issues. However, it is worth noting that due to the global economic crisis, banks have taken more cautious approaches to lending.

VII EMPLOYMENT LAW

In a merger scenario, the surviving company assumes the labour relations and liabilities of the absorbed company. Similarly, in stock acquisitions the target company retains responsibility for labour relations and liabilities. Asset acquisitions present a special case. If the sale comprises all or substantially all of the assets so that the business operation is transferred, both the buyer of the assets – and new employer – and the seller of the assets are, for a one year period following the acquisition, jointly and severally responsible for all labour liabilities arising prior to the acquisition of the assets or business. Furthermore, employees retain all their rights and benefits and no adverse changes can be made to their terms of employment. Thus, in many asset acquisitions and insofar as may be legally feasible, buyers require sellers to terminate all or certain labour relations as a condition precedent to closing, in order to be able to rehire some employees on more favourable terms to the extent permitted by law. Labour unions and employees must be notified of the employer substitution even though they cannot prevent it from taking place.

VIII TAX LAW

The sale of shares of Panamanian or foreign companies with taxable activities in Panama that are registered with the national Securities Commission and traded in a public exchange are not subject to capital gains taxes in Panama. However if these shares are sold as a result of a tender offer, the transfer will be subject to capital gains taxes in Panama.

Likewise, the direct or indirect private sale of shares in companies with assets or taxable activities in Panama is subject to capital gains taxes in Panama. The capital gain is calculated at a flat rate of 10 per cent of the gain (price less the cost of acquisition), irrespective of the holding period of the security. However, this tax is subject to anticipatory payment by withholding, as the purchaser must withhold 5 per cent of the total purchase price of the shares as fiscal agent for the Panamanian government. The company whose shares are transferred is jointly and severally liable with the purchaser for the collection and payment of the 5 per cent withholding tax. The 5 per cent withheld by the purchaser is treated as a credit against the capital gain tax payable by the seller. The seller can treat said credit as a definitive payment of its capital gain tax or apply for a tax credit if the 5 per cent withholding tax is excessive in light of the gains actually realised on the sale of the shares. The tax credit must be requested and applied in the same fiscal year that the gain is realised.

Another recent development in tax was the adoption of Law No. 49 of 2009, which introduced a dividend tax of 5 per cent on the distribution of foreign-sourced earnings by Panamanian companies with taxable activities in Panama. Historically, dividends paid by a Panamanian company of Panama sourced income were subject to a 10 per cent withholding tax – with the rate increasing to 20 per cent for dividends paid on bearer shares – and the distribution of earnings by the same company resulting from business outside of Panama (i.e., foreign-sourced income) was not subject to a dividend tax in Panama. The new tax reform maintained the dividend tax on the distribution of Panama source income, and introduced a 5 per cent dividend tax on the distribution of foreign sourced income. For corporate M&A, this means that under certain scenarios, when a Panamanian corporate seller with taxable activities in Panama declares a dividend to its shareholders of the proceeds from a cross-border transaction, said dividend will be subject to a 10 per cent withholding tax over the portion of the proceeds which correspond to the operation with Panama-sourced income and it will be subject to a 5 per cent withholding tax over the portion of the proceeds that correspond to the operation with foreign-sourced income.

On 15 January 2009, Law No. 4 of 2009, which regulates limited liability companies ('LLCs'), came into effect ('the LLC Law'). The 2009 law repealed a prior law on limited liability companies dating from 1966. The LLC Law allows greater flexibility in the creation and use of LLCs by quotas, and among its salient features is its classification as a pass-through entity, and therefore an entity ignored for income tax purposes.

IX COMPETITION LAW

There is no mandatory pre-merger control in Panama for the approval of mergers and other forms of economic concentrations. However, since the first competition law was enacted in 1996, concentrations within the Panamanian market by competitive agents are subject to scrutiny. The 1996 law and its regulations were repealed and a new competition law was enacted in 2007.

Law No. 45 of 2007 ('the Competition Law') establishes a voluntary notification system for potential mergers or economic concentrations with the Authority of Consumer Protection and Defence of Competition ('the Authority'). The transaction is notified to the Authority for verification prior to consummation.

The Law defines an 'economic concentration' as the merger, acquisition of control, or any other act pursuant to which corporations, associations, shares, trusts, establishments or any other kind of assets are combined, and which occurs between suppliers or potential suppliers, customers or potential customers, and other competing or potentially competing economic agents.

The Competition Law prohibits economic concentrations whose effects may unreasonably restrict or harm free competition. It applies to any acts or practices whose effects take place in Panama, regardless of where those acts have been carried out or perfected.

Notwithstanding the above, economic concentrations with restrictive effects on competition may obtain clearance from the Authority if the restrictive effects of the concentration are outweighed by its contribution to obtaining further efficiencies, such as:

a improvements in commercialisation and production systems;

b fostering technical and economic progress;

c improvements in the competitiveness of the industry; and
d contributions to consumer interests.

The following concentrations are not considered prohibited economic concentrations under the Competition Law:

a accidental associations that are formed for a definite time period to develop a particular project;
b concentrations between competitors or non-competitors that do not have harmful effects on competition and the market; and
c economic concentrations involving an economic agent that is insolvent, so long as the insolvent economic agent can show that it has unsuccessfully sought purchasers that are not competitors.

The Competition Law states that the notification for verification of a potential merger or economic concentration is made by the 'interested economic agent' to the Authority. In practice, the notification to the Authority is a collaborative process in which the target entity and the potential purchaser furnish information. The Authority has up to 60 calendar days from the date the notification is filed, or if requests for further information are made, the date of receipt of all further information, to make a formal decision in which it approves or rejects the economic concentration. If the Authority does not make a decision within that timeframe, the economic concentration is deemed approved. If the Authority rejects the economic concentration, the decision may be appealed.

If advance verification for the economic concentration is sought and it is approved, the economic concentration cannot be subsequently challenged. If no advance verification is sought, and after the consummation of the transaction, the Authority considers the economic concentration to unreasonably restrict or harm free competition, within the three years following the effective date of the transaction the Authority may file a lawsuit with a specialised superior court, seeking that certain conditions be imposed on the parties to ensure competitiveness in the marketplace, or seeking a partial or complete divestiture of the concentration.

Executive Decree No. 8-A dated 22 January 2009, enacts Regulations for the Competition Law ('the Regulations'), and on 16 July 2009, the Authority issued Guidelines for the Control of Economic Concentrations ('the Guidelines'). In general, the Regulations and Guidelines develop in more detail certain matters outlined in the Competition Law.

X OUTLOOK

As the Panamanian economy continues to grow and forecast numbers remain relatively promising in comparison to other countries and regions, future interest by multinational corporations in local markets is expected to increase. The consolidation process in the banking industry has not finished in Panama. Rapid changes in technology are likely to increase the level of cross-border mergers and acquisitions. Undoubtedly, the body of legislation affecting mergers and acquisitions will continue to evolve and transactions will become more and more complex.

EDUARDO DE ALBA

Arias, Fábrega & Fábrega

Eduardo de Alba is an accomplished partner with extensive experience in the area of mergers, acquisitions and joint ventures. A strong lawyer with skills in different disciplines, he also heads the firm's regulatory work practice group.

Mr de Alba has been recognised as a leading lawyer for his M&A work by publications like *Chambers Global* and the *IFLR*.

From 1999 to 2005, he was a member of the board of directors of Interlaw.

Mr de Alba obtained his BA in 1972 from Georgetown University and his JD from the Louisiana State University Law Center in 1975. He was admitted to the Bar of Panama in 1976.

JULIANNE CANAVAGGIO

Arias, Fábrega & Fábrega

Listed among leading players identified by the *LatinLawyer 250* in its 2010 edition, associate Julianne Canavaggio received top reviews from clients and peers alike for her sustained achievements and was praised as a lawyer 'increasing in prominence'.

Ms Canavaggio's practice focuses on mergers, acquisitions and joint ventures; corporations; banking and finance; and securities regulation.

Prior to joining the firm, Ms Canavaggio worked as an associate with Baker & McKenzie in Houston.

Ms Canavaggio obtained her BA from Harvard University in 2003 and her JD from Tulane University Law School in 2006. She was admitted to the Bar of Panama in 2009 and Texas in 2006.

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