

THE  
Mergers &  
Acquisitions  
Review

THIRTEENTH EDITION

Editor  
Mark Zerdin

THE LAWREVIEWS

# THE MERGERS & ACQUISITIONS REVIEW

THIRTEENTH EDITION

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# PREFACE

2018 was the year of the mega-deal, with an unprecedented number of big-ticket mergers taking place across a range of jurisdictions and sectors. In the first six months of 2018, global deal value rose by 59 per cent compared to 2017, despite volumes falling by 12 per cent. Although there was a considerable drop off in activity in the second half of the year, 2018 nonetheless saw robust overall performance by market participants, with global activity in 2018 exceeding US\$3 trillion for the fifth consecutive year.

The United States remained the most targeted and acquisitive region globally in 2018; however, the deal-making landscape in the US for the remainder of 2019 presents a mixed picture. On the one hand, tax reform, a more relaxed US regulatory climate and growing cash reserves present a favourable environment for investors. On the other, dealmakers are likely to be concerned by the trade dispute between the US and China – which is already threatening economic growth and, at the time of writing, shows no sign of abating – and the ongoing uncertainty regarding antitrust policies, which may lead to increased scrutiny of M&A deals.

In Europe, after a record-breaking start to the year, the prolonged uncertainty caused by stuttering Brexit negotiations and wider political tensions across the continent finally caught up with dealmakers in the second half of 2018. In line with a softening of the global economy, the value of European deals in H2 plummeted to its lowest level since 2013, and the volume of transatlantic deals between North America and Europe also fell by 29 per cent year-on-year.

One of the main disruptors to M&A activity over the past 12 months has been the rise in political intervention in cross-border deals. In particular, concerns over national security have led to the tightening of foreign investment regimes and antitrust regulations, coupled with more active enforcement by regulators. This growth in protectionism is likely to remain one of the main obstacles facing dealmakers in the near future.

Nevertheless, looking forwards into the remainder of 2019, there is certainly cause for optimism: private equity continues to enjoy record-breaking levels of dry powder, and developments in technology are driving both the sector itself and the facilitation of deals more broadly. Finally, and perhaps most importantly, the past 12 months have highlighted the resilience of companies and private equity firms in their navigation of global political uncertainty and economic shifts.

I would like to thank the contributors for their support in producing the 13th edition of *The Mergers & Acquisitions Review*. I hope the commentary in the following 47 chapters will provide a richer understanding of the shape of the global markets, and the challenges and opportunities facing market participants.

**Mark Zerdin**

Slaughter and May

London

July 2019

# PANAMA

*Andrés N Rubinoff<sup>1</sup>*

## I OVERVIEW OF M&A ACTIVITY

Panama's economy continues to lead in Latin America, with a growth in gross domestic product (GDP) of 3.7 per cent in 2018. The economy has been supported by the expanded Panama Canal and the appreciating US dollar, with a forecast a real GDP growth above 5.8 per cent for 2019. To that end, Standard & Poor's recently upgraded Panama's sovereign credit rating to BBB+, announcing the improved rating together with a stable outlook at least a month before the outcome of presidential elections on 5 May 2019.

M&A activity in Panama was expected to remain robust throughout 2019, as industries such as logistics, energy and mining maintained a vibrant economic growth, while others companies in the retail and financial sectors are ripe for consolidation or acquisition. Large infrastructure projects, such as the US\$2.6 billion construction of a third metro line, are also contributing factors in the increase in foreign direct investment in Panama. The third metro line, a monorail system stretching 25km west of Panama City, is currently at the bidding process stage, with four bidders aiming to procure the contract. It will cross the Canal over the Fourth Bridge, which will house the metro line and eight lanes to meet the needs of the rapidly growing cities west of the capital. The Fourth Bridge project has an expected cost of around US\$1.5 billion and was granted to Consorcio Panamá Cuarto Puente, a joint venture between China Communications Construction Company LTC and China Harbour Engineering Company LTD.<sup>2</sup>

The energy sector in Panama will continue to experience government and foreign direct investment. Given Panama's long-running sustained economic growth, it is unsurprising that energy demand in the country is expected to keep increasing. The difference between the first trimester of 2018 and 2019 reflects a growth of 4.1 per cent.<sup>3</sup> Investment in the clean energy sector has also experienced significant growth and, at the going rate, clean energy production has produced significant achievements, such as the inauguration of the Ikakos Power Plant, a solar energy plant that produces around 40 megawatts yearly.<sup>4</sup> The government is currently working on the bidding process for Transmission Line 4, which will have cost approximately US\$450 million, and which will cement the connection between heavy hydroelectric energy

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1 Andrés N Rubinoff is a partner at Arias, Fábrega & Fábrega.

2 <https://elcapitalfinanciero.com/inicia-la-construccion-del-cuarto-puente-sobre-el-canal-de-panama/>.

3 [https://www.contraloria.gob.pa/INEC/archivos/A4012019\\_oferta\\_elec.pdf](https://www.contraloria.gob.pa/INEC/archivos/A4012019_oferta_elec.pdf).

4 <https://www.efc.com/efc/america/economia/clinton-elogia-a-panama-por-su-revolucion-en-la-utilizacio-n-de-energia-limpia/20000011-3885837>.

production in the west part of the country and the east part of the country's increasing demand.<sup>5</sup> This project has attracted foreign investment, but the bidding process has not found a bidder that can comply with the requirements set forth by the government.

The International Monetary Fund (IMF) Western Hemisphere Department recognised Panama's positive future growth due to:

- a* the expansion of the Panama Canal;
- b* the development of several services industries;
- c* the approval of free trade agreements with the United States, the European Union and Canada; and
- d* the growth of the mining industry.

The latter has increased thanks to copper mining, which element has only recently started to be tapped. The Cobre Panama copper mine, controlled by First Quantum Minerals, is said to be practically operational: Cobre Panama is the nation's most important private investment project, with an estimated production of 320,000 tonnes of copper per year. As noted in an IMF Country Report for 2014, the copper mine was expected to bring about 'US\$6½ billion over 2013–17, about US\$1½ billion of which have already invested'.<sup>6</sup> The IMF calculates that the mining project will contribute around 1.5 per cent of Panama's GDP in 2019.<sup>7</sup>

Panama is consistently rated by international indexes as one of the best countries in Latin America for business and investment. The World Bank's Doing Business 2019 'ease of doing business' index ranked Panama 79th of the 190 surveyed countries. This may be due to its encouragement of foreign investment through legal incentives. In 1998, the government enacted the Investment Stability Law, which guarantees equal treatment to foreign investors under the law as is given to their domestic competition, and guarantees the same commercial and fiscal conditions for 10 years to foreign investors who invest at least US\$2 million in Panama. Under Law 41 (2007), Panama has motivated multinational companies to locate their headquarters in Panama through tax incentives. As of May 2019, 147 international companies have been established under the Law, including major multinationals such as Hyundai, Procter & Gamble, AES, Halliburton, Hewlett-Packard, Peugeot/Citroën, Pan-American Life Insurance Company, Caterpillar, LG, 3M, Western Union and Roche, owing to the various taxation, immigration, labour and employment incentives offered specifically to benefit multinationals that establish their regional offices or headquarters in Panama.<sup>8</sup>

## II GENERAL INTRODUCTION TO THE LEGAL FRAMEWORK FOR M&A

The relevant Panamanian laws and regulations governing business combinations include the Corporations Law, the Limited Liability Company Law and the Commercial Code, which is supplemented by the Civil Code. As combinations generally cause taxable events, the Tax Code and its regulations (especially Executive Decree 18 of 1994, which establishes a special regime regarding share-for-share mergers) and Law No. 18 of 2006, which created

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5 [impresa.prensa.com/economia/BM-licitaria-linea-transmision\\_0\\_4721527869.html](http://impresa.prensa.com/economia/BM-licitaria-linea-transmision_0_4721527869.html).

6 [www.biv.com/article/2017/5/first-quantum-minerals-commission-55b-panama-coppe](http://www.biv.com/article/2017/5/first-quantum-minerals-commission-55b-panama-coppe).

7 <http://laestrella.com.pa/economia/cobre-panama-iniciara-exportaciones-junio-pesar-fallo-corte/24112323>.

8 <https://elcapitalfinanciero.com/147-empresas-sem-operan-en-panama/>.

a special capital gains regime, are also pertinent. In the case of publicly traded companies, the Securities Law<sup>9</sup> and its regulations govern tender offers, proxy statements and rules of disclosure, among other matters.

Business combinations in Panama are usually structured as share or asset purchases, tender offers or mergers, but other techniques can also be used. One example is the capitalisation of shares of two operating companies to a holding company incorporated for that purpose with joint participation in the holding company. In the case of publicly traded companies, combinations usually involve a two-step process that begins with a tender offer (either for shares, cash or a combination of both) followed by an actual merger.

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

Corporate and takeover law can be divided into two kinds of transactions: mergers and share and asset purchases. In the case of mergers, Panama law allows a company to be absorbed by another regardless of the place of incorporation of either firm (merger by absorption). It also allows two companies to merge, forming a new consolidated body. Once a merger becomes effective, the absorbed company ceases to exist as a legal entity, and the surviving company assumes all the assets, rights, licences, capital, liabilities and obligations of the absorbed company by universal succession. Unless the articles of incorporation state otherwise, a merger agreement must be executed by a majority of the directors of each company, and approved by the holders of a majority of the issued and outstanding shares of each firm. The merger agreement must then be registered with the Registry of Companies in Panama to bring it into effect, unless a later effective date is defined in the merger agreement.

Regarding share and asset purchases, unless the articles of incorporation state otherwise, the acquisition of a company generally requires approval from a majority of the directors of the acquiring company regardless of whether it is structured as a share or an asset purchase. On the other hand, the sale of a company, if it represents all or substantially all of the assets of the seller, generally requires approval from both a majority of the directors and holders of all issued and outstanding shares with the voting rights in the event of selling a company.

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

Foreign direct investment continues to be a principal driver of M&A activity and has been on the rise in the past couple of years: due to the nation's strengthened alliance with China, we have seen increased interest in the acquisition of local companies by Chinese conglomerates, which have also heavily invested in major engineering, procurement and construction projects. Political instability in nearby Latin American countries has also been a substantial driver for investment into Panama, as individuals and companies seek to diversify their country risk.

Generally there are no foreign ownership restrictions in Panama. Because of issues of national security and national interest concerns, however, ownership of local companies by foreign governments or nationals is restricted in certain industries, including, *inter alia*, aviation, radio and television, and retail trade. In the case of the retail services market, foreign participation is generally prohibited, with very few exceptions.

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9 The Securities Law, Decree Law No. 1 of 1998.

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

Most of the important sectors in the Panamanian economy have been subject to cross-border acquisitions, but M&A activity is expected to continue to be distributed across several industries, led most likely by the traditional financial services (including insurance) and energy sectors, followed by the food and retail industries (both wholesale and consumer sales). The aftermath of the Panama Papers and the controversy surrounding money laundering allegations involving a prominent retail trade group have led to stricter tax, regulatory and anticorruption compliance legislation in the country. Consequently, consolidation among medium and small banks is still expected to pick up, spurred by reduced access to correspondent banks, which are limiting their services because of local regulatory burdens, and increased compliance standards imposed on foreign banks and the perceived reputational risk stemming from the publication of the Panama Papers. This current issue in the Panamanian financial services sector may have further long-term implications. For example, recently Banco Panamá, a small bank located in Panama, merged with Banco Aliado in a transaction valued at US\$210 million.

Given the demand for energy in Panama and the region, the energy sector has been the object of recent important acquisitions and new market entrants, including the acquisition by CELSIA (part of the Colombian conglomerate Grupo Argos) of GDF Suez assets in Panama and Costa Rica for a reported US\$830 million, and InterEnergy Holding's simultaneous acquisition and US\$300 million project financing of the construction of Phase II and Phase III of the Penonomé wind power plant, the largest wind farm in Central America. Now operational, the plant produced 401,734MWh in 2018, representing 4 per cent of the country's total energy demand. Significant acquisitions and joint ventures are expected in the next few years in this sector as Panama continues to find and incentivise new sources of energy for its rising demand, while further regulating its existing non-renewable and renewable resources.

Increased deal activity is expected following the now-complete Canal expansion and the growth of the port industry with regard to the logistics, transportation and distribution and maritime industries, as this sector saw growth of 7.3 per cent last year. In the telecommunications sector, Millicom International Cellular SA acquired 80 per cent of Cable Onda, SA, a leading provider of broadband internet, pay-TV, fixed telephony and B2B telecommunications services in Panama, for a reported US\$1,462 million.

In recent years, M&A deals in Panama have had many drivers. Certain deals have been instigated by a need to consolidate in a very competitive environment, others have been undertaken to control costs and exploit synergies, and yet others have been fuelled by the global economy and the need to develop new international markets and expand market share. Some of the largest transactions in Central America have included Panamanian target companies, independent of whether they are an operating company or a holding company registered in Panama with operations in the region. Additionally, we are seeing a move from New York law or New York-run deals to Panama law or Panama-run deals for Latin America-based transactions that do not necessarily have a connection to Panama.

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

M&A financing in Panama is usually provided by local and international banks, as there are no limitations on international lending. With the end of the financial crisis, deals have also been increasingly funded through private equity firms or through local and international securities issues.

## **VII EMPLOYMENT LAW**

In a merger scenario, the surviving company assumes the labour relations and liabilities of the absorbed company. Similarly, in share acquisitions, the target company retains responsibility for labour relations and liabilities. Asset acquisitions, however, present a special case. If the sale comprises all or almost all the assets, causing business operations to be transferred, both the buyer of the assets – the new employer – and the seller are, for a period of one year following the acquisition, jointly and severally responsible for all labour liabilities that arise 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, insofar as may be legally feasible, buyers require sellers to terminate all or certain labour relations as a precondition to closing a deal, in order to rehire some employees on more favourable terms. Labour unions and employees must be notified of the employer substitution even though they cannot prevent it from taking place.

## **VIII TAX LAW**

One of the main components of any sell-side deal structuring is taxation. The structure of an acquisition is usually influenced to a large extent by the need to make a transaction tax-effective for the seller, without causing adverse tax consequences to the buyer. As Panama generally follows a territorial system of taxation, only Panama-source income (generally income and capital gains realised in connection with a trade, business or real estate transaction in Panama) is taxable. Thus, mergers or acquisitions of companies organised in Panama that do not carry out any trade or business or own assets within the country are generally not taxable. Mergers or acquisitions are generally structured as either share-for-share transactions or share-for-cash transactions, or a combination of both. Acquisitions can also be fashioned as a straight purchase of shares or a purchase of assets. A brief description of the tax treatment for each follows.

Share-for-share mergers are tax-free transactions, provided that no cash is paid out (except up to 1 per cent of the value of a transaction for adjustments of fractional shares) and certain other accounting parameters are followed. In a share-for-share merger, the shareholders of the merged company keep a tax basis on the shares of the surviving company that they receive equal to their average pre-merger tax basis of the surrendered shares.

Share-for-cash mergers, on the other hand, are not tax-free transactions. Gains realised by sellers in these transactions, which are deemed to be gains from Panama-sourced income, are subject to a 10 per cent capital gains tax. The capital gain is the difference between the selling price allocated to Panamanian sources and the tax basis of the shares owned by the selling shareholder. Furthermore, the law requires buyers to withhold 5 per cent of the total purchase price allocated to Panamanian sources (as an advance of the capital gains tax) and directly pay this amount to the tax authorities within 10 days of the transfer of the shares. If the 10 per cent capital gains tax on the realised capital gain is less than the 5 per cent advance



withholding, sellers can request a tax credit for the difference. This credit must be used in the same fiscal year as that in which the capital gain is realised. Alternatively, sellers can choose to treat the 5 per cent advance capital gains withholding as the final and definitive capital gains tax payable in connection with the sale of the shares. In practice, most sellers pay the 5 per cent purchase price capital gains withholding, as it is difficult to request and use the tax credit in the same year that the transaction took place.

Share purchases are subject to a 10 per cent capital gains tax on Panama-sourced gains in the same manner that share-for-cash mergers are taxed, including the 5 per cent advance withholding obligation. The Department of Revenue of the Ministry of Economy and Finance has repeatedly taken the position that capital gains tax applies to the sale of the shares not only of Panamanian corporations, but also of any upstream company, regardless of its jurisdiction of incorporation, as long as this company, directly or through one or more subsidiaries, has Panama-sourced income. Consequently, gains derived from the direct or indirect transfer of shares of a legal entity that has obtained Panama-sourced income is subject to tax at a rate of 10 per cent.

Following a tax reform (Decree Law 135 of 2012), if a transaction involves, indirectly, the transfer of shares of a Panamanian company with Panama-sourced income, the seller and buyer can now apply pre-established calculations to determine the capital gains tax due on the percentage of a transaction's purchase price that is attributable to Panamanian assets. To pay the capital gains tax, the buyer and seller will need to file a joint sworn affidavit setting forth the total capital gains tax paid and the calculations used to arrive at the figure. In addition the buyer, who is responsible for the payment, must obtain a temporary tax identification number in Panama, known as 8-NT, and report and pay the capital gains tax. This temporary registration has no additional tax implications or reporting requirements in Panama for the buyer; however, buyers and sellers must be aware that the local tax authority has recently ramped up the audit and enforcement of capital gains tax, particularly in high-profile transactions. Recently, the National Assembly enacted Law No. 70 dated 31 January 2019, which modifies the criminal code and sanctions as a crime the act of tax evasion in excess of US\$300,000.

Asset purchases are generally taxable events in Panama. Gains realised on the sale or disposition of assets located in Panama are generally subject to a 10 per cent capital gains tax. In addition, the transfer of chattel property, such as inventory or equipment, is subject to a value added tax equal to 7 per cent, and the transfer of real estate is subject to a 2 per cent transfer tax. In addition, buyers of an ongoing business concern must be aware that they will become liable for the past taxes of the business, even if they are buying the assets of the business and not shares of the company.

Frequently, M&A transactions involve either a pre-closing dividend to exclude assets from a transaction or a post-closing dividend to distribute gains to shareholders. In this regard, as a general rule, corporations in Panama are subject to a 10 per cent dividend tax (20 per cent if the shares are issued to the bearer) on Panama-sourced income. Thus, income that is not Panama-sourced is generally not subject to dividend tax. However, following the recent tax reform, if the company paying the dividend engages in commercial or business activities in Panama that require the company to obtain a business licence, then in addition to paying the 10 per cent dividend tax on Panama-sourced income, it is also subject to a 5 per cent dividend tax on non-Panama sourced income.

Goodwill is another frequent point of conflict between buyers and sellers. Buyers generally want to be able to claim a tax deduction for the amortisation of any goodwill paid in an acquisition. However, amortisation of goodwill is only deductible in Panama if the seller recognises it as income on its annual tax return.

## IX COMPETITION LAW

There is no mandatory merger control approval process in Panama; the process is entirely voluntary. That said, with the new antitrust and competition regime established by the Competition Law, economic concentrations created by the mergers of conglomerates within the Panamanian market have come under increasing, albeit still limited, scrutiny by regulators. The Competition Law prohibits economic concentrations whose effects may unreasonably restrict or harm free competition. An economic concentration is defined 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 Law applies to any acts or practices that may unreasonably restrict or harm free competition, and whose effects take place in Panama, regardless of where those acts have been carried out or perfected.

The Competition Law does not prohibit all economic concentrations, but only those whose effects may unreasonably restrict or harm competition. In addition, the Competition Law expressly provides that the following business combinations shall not be deemed prohibited economic concentrations:

- a* joint ventures formed for a definite period of time to carry out a particular project, which is also contemplated in other jurisdictions;
- b* economic concentrations among competitors that do not have harmful effects on competition and the market; and
- c* economic concentrations involving an economic agent that is insolvent, if certain conditions are met, which is, roughly speaking, equivalent to the failing company exemption prevalent in other jurisdictions.

Moreover, economic concentrations with restrictive effects on competition may obtain clearance from the Competition Authority if their restrictive effects are outweighed by their 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 an industry; and
- d* contributions to consumer interests.

If advance verification for an economic concentration is sought and approved, the economic concentration cannot be subsequently challenged. If no advanced verification is sought and the transaction has been consummated, the Competition Authority may file a lawsuit with a specialised superior court within three years of the transaction's effective date if it considers the economic concentration to unreasonably restrict or harm free competition, seeking that conditions be imposed on the parties to ensure competitiveness in the marketplace, or seeking a partial or complete divestiture of the concentration (or both).

## **X OUTLOOK**

Panama's economy is expected to grow at a moderate and sustainable rate, despite the perceived reputational damage to the financial and legal services industries. On this matter, the government has countered issues by cooperating and aligning with international standards, thus making firm commitments to creating a more transparent environment for foreign investors. For example, the government has committed to adopt data-sharing arrangements consistent with US Foreign Account Tax Compliance Act and the OECD's Common Reporting Standards, and has implemented several strict anti-money laundering regulations applicable to both the financial and non-financial sectors. Multinational corporations, regional conglomerates and private equity firms continue to seek and take advantage of the country's unique geographical position, its free market system and investor-friendly climate, which will cause the prevalence of cross-border M&A in Panama to increase. A recently adopted bankruptcy law (similar to Chapter 11 under the US federal bankruptcy laws) is also likely to spark interest in distressed assets and companies. Undoubtedly, Panama will remain in the spotlight for foreign investors, and the body of legislation governing M&A in Panama will continue to evolve as cross-border transactions become more complex.

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