

Panama

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Panama has historically been a crossroads for international commerce due to its strategic location at the heart of the American continent. It has a population of 3.5 million. Its official language is Spanish, but English is widely spoken, especially within the services industry. Its economy has recently witnessed extraordinary growth, with gross domestic product increasing by 10 per cent in 2007. The main driver of this remarkable trend is the expansion of the Panama Canal, which began in 2007 and is scheduled for completion in 2014, at an estimated cost of approximately \$5.2 billion.

The Panama legal system is based on civil law. The basic statutes are the Constitution, the Civil Code and the Commercial Code.

I. The legal framework and the effectiveness of court processes/legal remedies

1.1 Describe the nature and the effectiveness of the following:

(a) Debt recovery remedies where the creditor has no security

An unsecured creditor may seek debt recovery through an ordinary action, an executory action or a bankruptcy proceeding. If a creditor does not have a document issued by the debtor and showing the clear existence of an obligation that is due, it must resort to an ordinary action in order to obtain a court ruling confirming the existence of the obligation in question.

In an ordinary action the parties have ample opportunity to submit to the court evidence supporting their respective positions, as well as to file motions and submit arguments.

A creditor may pursue an executory action to obtain the enforcement or require the performance of obligations which are clear and past due. In order to file such an action the obligation that is sought to be enforced must:

- be evidenced in writing in a document issued by the debtor and constituting full proof against it; or
- be contained in or result from a final judgment rendered by a court or from another judicial resolution having executory force under the Panama rules of procedure.

Such documents are known as enforcement titles. In an executory action, if the trial court determines that the document submitted by the plaintiff is an enforcement title, it will enter an order directing the defendant to satisfy the obligation in question. The defendant may present defences, which normally consist of defences aimed at showing that the obligation has been extinguished or is null and void. After serving notice on the defendant of the court order, the plaintiff may request that the court enter a levy on the defendant's assets. After ruling on the exceptions, if any, and if the defendant has not satisfied the obligation, the proceeding enters into the phase of judicial sale of the seized assets.

An unsecured creditor may petition that the debtor be declared bankrupt (see section 1.1 (c) below).

(b) The enforcement of security

Security rights may be enforced through special proceedings contemplated in Panama's procedural laws. These special proceedings are more expeditious and afford the debtor a narrower set of defences to invoke.

(c) Corporate bankruptcy/liquidation processes

Bankruptcy proceedings in Panama are regulated by the Commercial Code and the Judicial Code, and are designed to provide for the orderly marshalling and sale of the debtor's assets for the purpose of paying its creditors' claims.

Bankruptcy proceedings may be initiated by the debtor or by any of its creditors. Under Panama law, a debtor must file a petition for a declaration of bankruptcy within two days of defaulting on the payment of an obligation.

In order for a creditor to request a judge that a debtor be declared bankrupt, it must hold a liquid and past due commercial claim against the debtor. A debtor may be declared bankrupt if it fails to pay at least one of its commercial debts.

Alternatively, a corporate debtor may approve its dissolution and proceed to liquidate its assets.

(d) Formal corporate rescue processes

No formal corporate rescue processes are contemplated under Panama law, except in the case of certain regulated industries (banking, insurance, brokerage houses).

(e) Informal corporate rescue processes

Informal corporate rescue processes are rare in Panama, although from time to time creditors have embarked on attempts to coordinate with debtors to secure the rescue or liquidation of a corporation.

1.2 What are the formal processes to effect a liquidation of the company's assets?

The shareholders may adopt a decision to dissolve a corporation. In this case a certificate of dissolution must be recorded with the Public Registry and a notice of dissolution must be published in a newspaper in Panama.

After dissolution, the directors assume

responsibility for liquidating or winding up the activities of the corporation, and are placed in the position of trustees for the benefit principally of the corporate creditors, and subsidiarily of the shareholders. Their role is to liquidate the assets, determine the extent of corporate debts, settle or reserve the same and distribute any surplus to the shareholders.

As trustees, the directors are personally and jointly and severally liable for the proper discharge of their responsibilities in winding up the corporation's affairs to those persons – that is, the creditors and, subsidiarily, the shareholders – to which they owe such duties. However, their liability is limited to the value of the corporate assets to be liquidated.

1.3 What is the effect on debt collection and the enforcement of security of:

(a) An adjudication of corporate bankruptcy/liquidation?

A declaration of bankruptcy has the following effects, among others:

- The judge will order the Office of Public Registry of Panama to abstain from recording any instruments in connection with the debtor. As a result of this order, the debtor will be unable to sell or otherwise dispose of its assets, and will be prevented from recording amendments to its articles of incorporation and changes in the composition of its board of directors and officers.
- The debtor will be prevented from managing and disposing of its assets and business. The administration of the debtor's assets and business will be taken over by a court-appointed administrator.
- Except in the case of debts secured by mortgages or pledges, all other debts will cease to accrue interest.
- All of the debtor's debts will be declared to be immediately due and payable.
- All civil proceedings initiated against the debtor in the four years preceding the bankruptcy date will be accumulated with the bankruptcy proceeding.

Secured creditors are not obligated to participate in bankruptcy proceedings and may seek to enforce their credits in separate proceedings.

For the effect of corporate dissolution and liquidation, see section 1.2 above.

(b) The commencement of a formal corporate rescue process?

As indicated above, Panama law does not provide for formal or informal corporate rescue processes. Following a declaration of bankruptcy, the proceeding may be terminated if the debtor and creditors representing at least 75 per cent of the debtor's obligations agree on the terms of repayment of such obligations, provided that such agreement is approved by the competent court.

(c) The initiation of an informal corporate rescue process?

See section 1.3(b) above.

1.4 Are insolvency procedures started in another jurisdiction in respect of a corporation incorporated in your jurisdiction recognised? In particular, what would be the impact of US bankruptcy proceedings being commenced?

In order for an insolvency procedure started in another jurisdiction to be recognised in Panama, the bankruptcy declaration made abroad must pass through a recognition process conducted before the Panama Supreme Court. In order for a foreign judgment to be recognised by the Supreme Court, it must fulfil the following criteria:

- The judgment must be final. A copy of the judgment must be authenticated by a Panamanian consul by means of apostille, as per the 1961 Hague Convention, prior to its submission to the Supreme Court.
- The defendant must be personally notified.
- The judgment must have been issued as a result of *in personam* proceedings against the defendant.
- The obligation in respect of which the judgment was rendered must be lawful and must not contradict public policy principles of Panama.
- The jurisdiction in which the judgment was rendered must be willing, in general terms, to recognise judgments issued by Panamanian courts.

Even before the Supreme Court has granted recognition, precautionary measures may be ordered in respect of assets of the debtor located in Panama, provided that they are sought through letters rogatory. If such measures are taken, resident creditors in Panama may initiate separate

bankruptcy proceedings in Panama, in which such creditors will have preference over creditors in the foreign bankruptcy proceedings.

The impact of a US bankruptcy proceeding in Panama will be governed by the principles and rules outlined above.

1.5 In what circumstances would the directors or officers of a company in financial difficulties face potential liability for continuing to trade? In practice, are any such provisions actually enforced?

As indicated above, a debtor is obliged to file a petition for a declaration of bankruptcy within two days of defaulting on the payment of an obligation. This obligation falls upon the administrators, directors or liquidators, who may be subject to penalties for culpable or fraudulent bankruptcy if the debtor is subsequently declared bankrupt.

2. What are the advantages and disadvantages of triggering a formal insolvency or corporate rescue procedure?

The main advantages of triggering a formal insolvency process are that the debtor loses control over the administration of its business, which is placed under the control of a court-appointed administrator, and a process to liquidate its assets commences immediately in order to satisfy its creditors.

The main disadvantages of insolvency proceedings are that:

- significant costs are incurred in paying for the fees of the court-appointed administrator; and
- it becomes difficult to reach agreements to seek the recovery of the debtor, due to the strict requirements set forth in the law for the termination of the bankruptcy proceeding through agreement of the parties (ie, an agreement between the debtor and creditors representing at least 75 per cent of the obligations, plus court approval).

3. What are the practical options for out-of-court restructuring?

In order for an out-of-court restructuring to succeed, it must have the agreement of all creditors and the debtor. If such agreement is not obtained, any creditor may seek a declaration of bankruptcy, thus jeopardising any agreement entered into by other creditors and the debtor.

4. What is the effect on the management of a company of:

4.1 An adjudication of corporate bankruptcy/liquidation?

The debtor will be prevented from managing and disposing of its assets and business. Administration of the debtor's assets and business will be transferred to a court-appointed administrator.

In the case of dissolution of a corporation, the liquidation of its assets is conducted by the directors, who are responsible for settling all outstanding liabilities and distributing any excess among the shareholders of the corporation.

4.2 The commencement of a formal corporate rescue process?

See section 1.1(d) above.

4.3 The initiation of an informal corporate rescue process?

Usually, in an informal corporate rescue process, the debtor continues in charge of the management of the business, but under close supervision of its creditors.

5. Parties in interest/key players

5.1 Who is responsible for the 'case management' control and administration of a corporate bankruptcy/liquidation, a formal rescue and an informal rescue?

In a bankruptcy proceeding, the court-appointed administrator is in charge of the administration of assets, liquidation of the debtor and distributions to creditors.

In case of the dissolution and liquidation of a corporation, the administration and liquidation are the responsibility of its directors.

As indicated above, no formal rescue process is contemplated under Panama law. In informal rescue processes, the management will normally continue in the hands of the debtor, but under close supervision of its creditors.

5.2 Who is responsible for preparing the restructuring plan in a formal or informal rescue?

No formal rescue exists under Panama law. In an informal rescue process, the restructuring plan will normally be drawn up by creditors and the debtor.

5.3 Who are the key players? What are their roles and responsibilities?

Debtor: A debtor which defaults on the payment of an obligation is obliged to file a petition for a declaration of bankruptcy. In the case of a corporation, this obligation falls upon the administrators, directors or liquidators. Where a declaration of bankruptcy is sought by a creditor, the debtor may challenge the petition. The debtor may also seek termination of the bankruptcy proceeding where an agreement with the creditors is reached and approved by the court.

Court-appointed administrator: The property and business of the debtor is managed by a court-appointed administrator. Upon the acceptance of his office, the administrator must prepare an inventory of the debtor's assets.

Within 10 days of the date on which notice of the declaration of bankruptcy is posted outside the court, creditors must file with the court their claims against the debtor. The administrator must prepare a report to the judge on the debtor's debts and obligations. Once this report has been accepted by the judge, it will be submitted to the general assembly of creditors for review and approval.

The administrator will then proceed to sell all of the debtor's assets. Within eight days of the conclusion of such sale, the administrator must prepare a report on the results of the sale.

Creditors: The general assembly of creditors, which comprises those creditors that filed their claims with the court within the specified 10-day period, shall review each of the debtor's debts, together with the judge, the debtor and the administrator. Any creditor whose claim is either rejected by the general assembly of creditors or not filed within the 10-day period may bring a separate action before the court for recognition and payment of its claim.

In an informal rescue process, the key players are the debtor and the creditors. Normally, the largest creditor will play a dominant role in the process, but it is important to obtain the participation of all creditors in order to ensure that the process is not affected by a creditor's petition for a declaration of bankruptcy.

6. What financial information is available to creditors?

In a bankruptcy proceeding, creditors have access to the files kept by the court, which contain the

claims presented by creditors as well as the reports submitted by the court-appointed administrator.

In an informal rescue process, the only information available is that which the debtor is willing to provide.

7. Common questions

7.1 Funding and the priority given to new money

(a) If an insolvent corporation requires urgent working capital funding, what difficulties are likely to be encountered in the provision of such funding?

In general, no difficulties will be encountered by a creditor which is willing to provide funding to an insolvent corporation. However, the law does not contemplate any special treatment for such funding.

(b) Are lenders providing new money, or debtor-in-possession financing, given any statutory priority?

No.

7.2 Ranking of creditors

In what order are creditors paid in a corporate bankruptcy/liquidation?

Any amounts owed to the National Treasury have preference over all claims, other than:

- credits secured by mortgages or pledges;
- labour obligations duly recognised by the labour authorities; and
- amounts owed to the Social Security Office.

The debtor's assets are distributed *pro rata* among all unsecured creditors. Secured creditors are entitled to have their credits liquidated with priority from the proceeds of the property that was pledged or mortgaged (after satisfying certain statutory liens), but share *pro rata* with the unsecured creditors for any unrecovered amounts.

7.3 Avoidance of antecedent transactions

Are there any legal provisions that might operate to invalidate the creation of security, the disposal of an asset or the payment of a creditor by a company in financial difficulties?

Any payments and any other acts performed by the debtor after the declaration of bankruptcy shall be null and void.

Transactions that take place prior to the declaration of bankruptcy may be declared null and void by a bankruptcy court if they were executed in the four years and 30 days prior to the date of the declaration of bankruptcy and if they fall within one of the following general categories:

- payment of debts not yet due;
- payment of debts in kind;
- granting of a security interest in respect of previously contracted obligations;
- gratuitous acts; or
- repudiation of an inheritance.

Any actions performed by the debtor at any time which are fraudulent or in detriment to the creditors may also be declared null and void.

Even judicial orders against the debtor which were unopposed by it, in detriment to the creditors, may be annulled by the court.

7.4 'Cram-downs'

What is the position of both unsecured and secured creditors that vote against, do not agree with or do not consent to either a formal or informal rescue plan?

See section 1.3(b) above.

7.5 Creditor protection

What action can creditors take if they are not satisfied with the conduct of either a formal rescue procedure or a corporate bankruptcy/liquidation?

See section 1.3(b) above.

Essentially, the creditors in a bankruptcy proceeding act collectively through the assembly of creditors. If a credit is rejected, the creditor affected is entitled to sue the bankruptcy administrator in a separate proceeding to seek recognition of its claim.

The law does not provide any special action to creditors which are not satisfied with the conduct of a corporate liquidation. In this situation, a creditor may resort to a precautionary measure to prevent the disposition of assets that may jeopardise the satisfaction of its credit.