

Shareholders' Agreements in Panama: Key Clauses and Their Practical Application

Shareholders' agreements have become an essential tool for structuring the relationship among shareholders in Panamanian companies, particularly in M&A transactions, private equity investments, joint ventures, and family-owned businesses undergoing professionalization. In this context, Panama's Corporations Law (Law No. 32 of 1927) provides considerable flexibility to create different classes of shares, establish voting thresholds, and design governance mechanisms tailored to the specific needs of each company. However, that same flexibility demands particularly careful drafting, as ambiguities or imprecise provisions can create gray areas that often evolve into disputes over time.

Within this framework, one of the most important elements of a shareholders' agreement is the concept of reserved matters—those decisions that, due to their strategic significance, require the affirmative vote of specific shareholders. These typically include approval of the company's budget, the assumption of significant indebtedness, the appointment or removal of key officers or senior management, the issuance of new shares, and the execution of mergers, acquisitions, spin-offs or other corporate reorganizations.

Reserved matters serve a dual purpose: they protect minority shareholders while helping preserve the strategic direction of the business. Their effectiveness, however, depends on appropriately calibrating approval thresholds to reflect the size and characteristics of the company, as well as ensuring their proper implementation at both the shareholders' assembly and board of directors' levels. Equally important is maintaining consistency between the shareholders' agreement and the company's constitutional documents, including its articles of incorporation, as registered with the Public Registry.

Alongside reserved matters, tag-along and drag-along rights play a fundamental role in regulating share transfers and protecting the interests of different shareholder groups. A tag-along right enables minority shareholders to participate in a sale initiated by the majority shareholder under the same economic terms, preventing them from being bound to an unwanted new shareholder. Conversely, a drag-along right allows a controlling shareholder to require minority shareholders to sell their shares on identical terms, a mechanism that is particularly relevant in private equity transactions where an orderly and efficient exit is often essential.

The practical effectiveness of these provisions depends on clearly defining key elements such as the ownership threshold required to trigger the mechanism, notice periods, documentary evidence of a bona fide third-party offer, and the procedures governing completion of the transaction.

Another significant risk in corporate governance arises from deadlock situations between shareholders holding reciprocal veto rights. In the absence of appropriate contractual safeguards, such situations can lead to operational paralysis and, in extreme cases, court-ordered dissolution of the company. For this reason, well-structured shareholders' agreements typically establish a staged dispute-resolution framework that begins with internal escalation mechanisms, progresses to mediation, and ultimately provides exit solutions.

Among the most common exit mechanisms are the Russian roulette mechanism, the Texas shoot-out mechanism, and cross put/call options supported by an independent expert valuation. However, it is important to recognize that certain mechanisms—particularly Russian roulette mechanisms—may produce outcomes that are economically coercive or even expropriatory where there is a significant disparity in liquidity or financial resources between shareholders. This reality should be carefully considered when designing the contractual framework.

Beyond the sophistication of the clauses themselves, the true effectiveness of a shareholders' agreement is tested when enforcement becomes necessary. Several structural considerations should therefore be addressed from the outset.

One of the most important is enforceability. Generally, private agreements are not automatically enforceable against third parties. Accordingly, incorporating key provisions into the company's constitutional documents, including



its articles of incorporation, registered with the Public Registry can strengthen their effectiveness by giving them both contractual and corporate force.

Similarly, dispute-resolution mechanisms are a critical component of any shareholders' agreement. In Panama, it is common for such disputes to be submitted to institutional arbitration, particularly before the Panama Center for Conciliation and Arbitration (CECAP) or the International Chamber of Commerce (ICC). Arbitration offers important advantages, including confidentiality, specialized decision-makers, and the ease of international enforcement provided under the New York Convention.

At the same time, parties should consider preserving access to judicial interim and precautionary measures in situations requiring urgent relief.

Remedies for breach also deserve careful consideration. In shareholder relationships, monetary damages alone are often insufficient to address the consequences of non-compliance. For this reason, it is advisable to include mechanisms that provide more effective and practical solutions, such as contractual penalty clauses, specific performance remedies, or automatic share transfer mechanisms triggered by certain breaches.

Ultimately, a truly effective shareholders' agreement is not one that merely reproduces standard clauses. Rather, it should accurately reflect the commercial realities of the business and the dynamics among its shareholders.

Panama's legal framework—supported by the flexibility of Law No. 32 of 1927, a well-established arbitration regime, and the reliability of the Public Registry—provides an ideal environment for the structuring of sophisticated and enforceable shareholder arrangements. Success, however, depends on drafting agreements that anticipate potential conflicts rather than simply reacting to them after they arise.



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