THE VULNERABLE SYSTEM FOR DETECTION OF BENEFICIAL OWNERS IN THE GOVERNMENT PROCUREMENT LAW OF PANAMA

BY PUBLIO CORTÉS

If all the providers of goods and services to the State were individuals and their identities were publicly known, citizens would have a better chance of knowing who sells to the State, which goods, what service, at what price, how often, etc.

Why is that important?
Because it is the best way for us to be confident that our taxes, and public funds in general, are being spent correctly.

With the current technology it is not difficult at all. In fact, our country has a website called **www.panamacompra.gob.pa** where, in general terms, there is a high level of transparency, mainly because by mandate of the Law; public bids, proposals and all their documents and decisions are mostly made public.

However, the issue of transparency on the identity of the interests that control the State providers requires additional controls when the State provider is a company. Let's take the most common case of a joint stock company for example. In such cases, what is sought is to avoid the corporate veil from preventing citizens from knowing which individuals are selling to the State.

Going a little deeper into the point, the transparency in knowing the true identity of those who sell to the State under companies and receive payments with public funds, contributes to reducing the risk of irregularities such as the following:

(1) That individuals or companies which in previous cases have been disqualified from contracting with the State, do so by placing a corporation in between, that makes them look as if they were different people.
(2) That the same interest of one individual or group of individuals, controls several companies and they all appear before a public bid to simulate that there was competition and that the best price and quality won; when in reality, whoever won was the same person or group of individuals.
(3) That public officials with conflicts of interest or legal prohibition, participate themselves or friends and clearly close relatives, in contracts with the State, using limited liability companies as a shield.
(4) That economic groups where money related to criminal acts are involved, become suppliers of the State, using commercial companies in between.

To face risks such as the above and other similar ones, our Government Procurement Legislation has some rules that favor transparency in the case of companies. However, although it is progress, in my opinion that regulation and its practical application is not sufficient and causes the system to be very vulnerable and does not fully comply with the proclaimed objective.

We support this point of view below.

For this explanation we will use the Single Text of the Government Procurement Law, ordered by Law 153 of 2020, however, it is important to mention that the regulations that we are now commenting on, are not the product of the recent reform and have been in force for several years, with the same content.

The general principle

Let's see article 26 of the Single Text of the Government Procurement Law, ordered by Law 153 of 2020:

"**Principle of Transparency.** In compliance with this principle, the following rules will be observed:
... ...
3. The actions of the authorities will be public and the contractor selection processes will be open to **any interested person**... ... ... " (The underlying is ours).

This provision applies to all elements of the Law and means that all interested citizens have the right to know the details of the State contractor selection processes. That is why the public bids and their details are published on the web.

Now, in the specific case of bidders and contractors who are companies, the Government Procurement Legislation has as a specific goal, among others, which is that all Panamanian citizens know the individuals that control the companies that sell to them, goods or

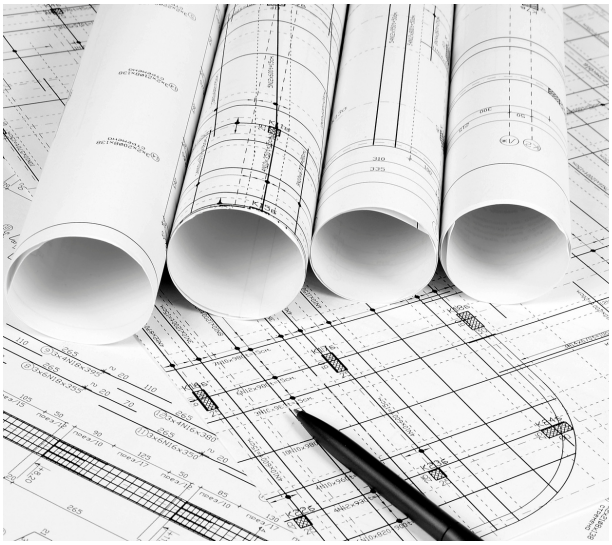
provide services to the State, paid with public funds.

How is it done? Through two **different and complementary control** systems. Let's see.

First control system: It is required that when it comes to bidders or contractors of the State whenever they are companies, all the shares of the company must be "Registered Shares", that is to say: that they be shares whose owner is recorded in the Share and in the Shares Book, so that you know who the owner is. **They cannot be bearer shares**.

Later in the Law it is emphasized that this requirement **also** applies to companies that participate in public contracts for amounts that exceed US$500,000.00.

The foundation of this first control system can be seen in articles 23 (last paragraph) and 41 (first paragraph), of the Single Text of the Government Procurement Law, ordered by Law 153 of 2020.



Second control system: Companies that participate in public contracting bids for **amounts exceeding US$500,000.00**, are required to disclose through a certification before the General Directorate of Public Procurement (DGCP), who the "final beneficiaries" are, understanding as such, the owners, **direct or indirectly**, of at least 10% of the issued and outstanding share capital. If the "Final Beneficiary" cannot be identified through share capital, the representatives or authorized persons of the corporation must also certify who the "Beneficial Owners" of the entity are.

The foundation of this second control system can be seen in article 41 (second paragraph), of the Single Text of the Government Procurement Law, ordered by Law 153 of 2020.

Why are both control systems complementary?

Because with **the first control method**, the shareholder is known. We know who the owner of the share is. The share is prevented from being issued to bearer. But that is not enough to know whom the individual that controls the bidder or contractor is. **It is not enough because registered shares can be issued under the name of other companies**. The fact that a share is nominative or registered does not mean that it must be in the name of an individual. In that case, the citizenship would still not know who the individuals who sell to the State are.

This is where **the second method of control** comes in. As this second

method of control refers to who, **directly or indirectly**, controls at least 10% of the share capital, this means that, if the registered shares are in the name of another company, that is, **indirectly** controlled, they must reveal who the individuals that control the share are anyway, insofar as they represent at least 10% of the issued and outstanding share capital.

In addition, if the "Final Beneficiary" is not identified on the side of the share percentage, in any case, the representatives or authorized persons of the company must certify who the "Final Beneficiaries" of the entity are.

Practical application by the General Directorate of Government Procurement

As the reader is a perceptive analyst, perhaps you are already identifying the weaknesses of the Government Procurement Legislation in terms of Transparency on "Beneficial Ownership" up to this point. But before going into that detail, let us complement the analysis with two pieces of information that refer to the practical application of that Legislation by the **DGCP**:

(1) I know for a fact, because of a specific case, that regarding the first control method, the **DGCP** accepts as true, that the Law orders the shares of all bidding companies must be “nominative”, however, it considers that it lacks the competence to ask the companies proposers for information that proves whether the shares are truly "Nominative".

(2) I also know for a fact, because of a specific case, that regarding the **second control method**, the **DGCP** accepts that the bidders and contractors in bidding procedures that exceed the amount of US$500,000.00 must certify to the **DGCP** who the “Final Beneficiary” is. However, the **DGCP** considers that this information is not public, that it cannot be shared with any interested citizen, that is, it is given the treatment that the Transparency Law (L. 6/02) gives to the information “Confidential” and “Restricted”.

Vulnerabilities of the legal and practical system described above

The **first method of control** applies to all companies, regardless of the amounts of the bidding procedures. It is enough to register the shares in the name of other companies and voilà, the requirement that they be "nominative" has been met, but in reality we do not know anything about the identity of the individuals who sell to the State. Even worse when we learn that the **DGCP** considers that it lacks the competence to even ask the proposing corporations, whether or not they comply with this insufficient requirement of the Law.

Taking into account a comment I made earlier on this article, some will probably think: but it’s so simple, the previous vulnerability is solved with the complementary application of the second control method.

However, this is actually partially correct, because - let us bare in mind - that the **second control method**,

relative to the Certification of the "Beneficial Owner" that is delivered to the **DGCP**, only applies to the cases of proponents companies in procedures for amounts that exceed US$500,000.00.

Meaning that, as of today, if we apply the Law as it is, spiced by the restrictive interpretation of the **DGCP**, it is perfectly possible for a company controlled by individuals with of illicit originated capital, organized as a public limited company to be a provider of the State, **without being obligated to reveal the identity of the individuals who control it**, provided that all shareholders are companies and are only proponents in public bidding procedures for amounts **not** exceeding US $ 500,000.00. Sure, there are issues such as experience that would prevent it from being so easy to make a partnership for each bidding procedure, but certainly the issue has room for improvement.

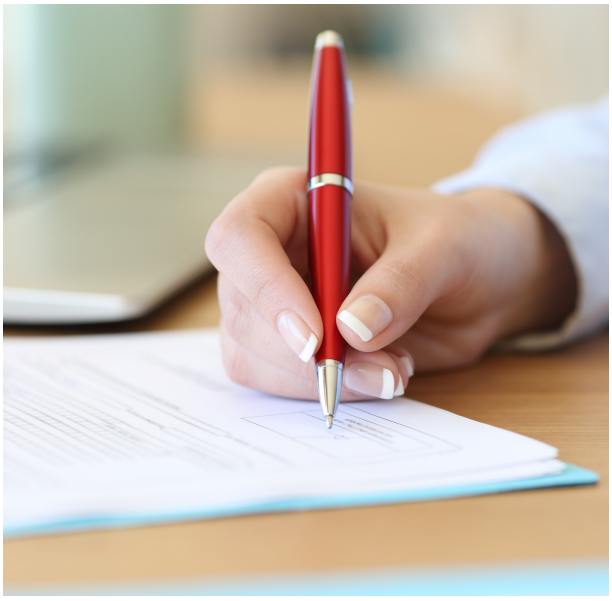
How can we then explain ourselves, that the Law esteems, that it doesn't really matter much, that there are deceiving risks with the "Final Beneficiaries" in matters regarding values of up to half a million dollars? I think that every dollar of public resources must be protected, especially in these times of economic crisis.

Regarding the **second control method**, the greatest vulnerability is the criterion contrary to the transparency that the **DGCP** has. According to this system, those responsible for the company in public bidding procedures for amounts greater than US$500,000.00, have to certify to the DGCP, the identity of the individuals who are the "Beneficial Owners".

However, the **DGCP** considers that this information is confidential and that it can only be known by competent authorities in specific cases.

According to the **DGCP**, Panamanian citizens who pay taxes cannot be interested in knowing the identity of individuals who control companies contracting with the State, within public bidding procedures for amounts greater than US$500,000.00

This secrecy of the **DGCP** makes the system totally vulnerable, since there is a huge number of companies with this status and it seems totally unrealistic to



me that the **DGCP** will have the administrative capacity to verify, each case, each year; if the information on the "Final Beneficiary" reported is true or whether or not it has changed. Therefore, there is a high risk that irresponsible contractors will mock the authorities, betting on administrative weakness.

Obviously, if citizens are given the opportunity to know in a public, transparent way and on the website, the identity of the "Final Beneficiaries" of all companies that contract with the State, a constant citizen audit mechanism is generated, which could help discourage cheaters.

The other serious vulnerability of the **second control method** has already been mentioned above, that is, in the Panamanian system of Government Procurement companies do not have to reveal the identity of the "Final Beneficiaries", when it comes to bidding procedures that do not exceed US$500,000.00.

Let's take this opportunity to mention that the Regulations of the Government Procurement Law do not provide anything on this matter (DE 439/20).

Additional annotations to the criteria of the DGCP

It is true that the Government Procurement Legislation of Panama has deficiencies in the matters dealt with on this Bulletin. Nevertheless, the Law is not all at fault, since the Law does not cover the two criteria mentioned above of the **DGCP**.

We will extend on the subject, below:

(1) In our opinion, a large part of this issue is resolved if we give it a finalist interpretation of the Government Procurement Legislation. In other words, if we ask ourselves, what is the purpose of said Legislation for the two control mechanisms explained above regarding bidders and contractors who are companies? What are you looking for? The answer is obvious: **it seeks to know who or whom are the individuals and the goods that they are selling to the State**. The idea is that citizens know who is benefiting from PUBLIC funds. **If that goal is not achieved, then the interpretation is not correct.**

(2) When it comes to Government Procurement, it is true that Law 6 of 2002, which regulates transparency in public management, applies. Now, it is important to mention that if it is about Government Procurement, the Law on this matter is the Special and privative Law and article 26 of the Single Text of the Government Procurement Law,

ordered by Law 153 of 2020, establishes that one of the law's principles is transparency in Government procurement procedures, a principle that includes as a rule of law the concept that "the actions of the authorities **will be public** and the contractor selection processes will be open to **any interested person**." This is the concept that must mastered.

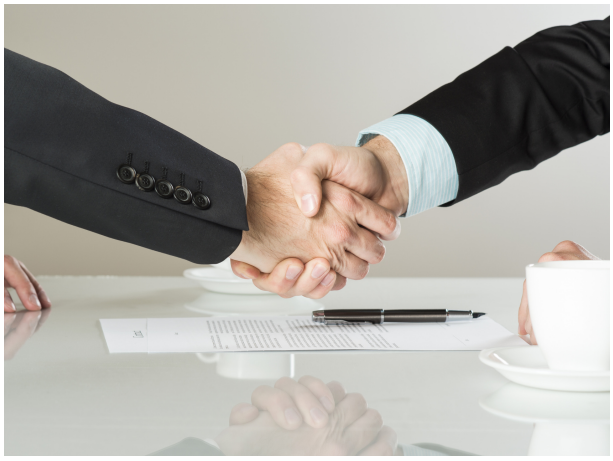
(3) We understand that there may be a point of view that tends to keep secrecy on the information of the individuals who control the companies that contract with the State, under the argument that this information could imply a commercial secret of the company. **That is the approach of the DGCP.** However, we consider that this approach is not convincing, since we are in a situation where it is a question of ensuring the correct use of **public funds**.

The general interest of all citizens to be able to know who is receiving payments with public funds, is above the particular interest of a company and its owners. If secrecy were kept, with the excuse of the company's right to privacy, then the objective of public review of what happens with public funds, which is, in the end, what is really sought could not be met with the Principle of Transparency of Government Procurement Legislation. These principles must be put into practice and avoid that they remain only in unsupported proclamations.

(4) In our legislation there is a similar example that can serve as a reference for this case. It is not the same, but it is worth making the comparison because it is illustrative. As seen in Agreement No. 2-2010 of April 16, 2010, of the Superintendency of Securities, duly amended, in the event of a Public Offering of Securities, an Informative Prospectus must be issued which is a document where the information of the transaction is disclosed to the knowledge of the investigative public. One piece of information that should be shared in this document is the following:

"*Name [of the issuer's shareholder], number of shares and percentage of which they are beneficial owners, the person or persons who exercise control over the issuer, in regards to the total of issued shares of that class.*" (Article 7 (X) (A) (1))

What is sought with this rule is that the public investor knows for sure who are the individuals that control the company that issues the securities. This information is very important because investors take it into account, among many others, to decide whether or not to invest. The rule exists to protect the general interest of the public investor and therefore the companies that make public offerings of securities are called "PUBLIC Companies".



Keeping the obvious differences, when the State contracts works and services with **public funds**, there is also a similar contrast of interests. On the one hand, there is the understandable interest of the company supplying the State in keeping its secrets. However, since its client is the State and the payment come from public funds, he must assume that reality changes, because all "shareholders" of the purchasing State, that is, all citizens who pay taxes, have right to know who is hired and how much is paid.

Companies who want to finance themselves with public offerings of securities, must just as well accept the rules that indicate that they have to transparently reveal who the people who control them are, for the knowledge of the investing public, so much so as the companies that control them. Any company that supplies goods and services for the government must assume that they have to transparently reveal who are the people who control them, for the knowledge of the citizens who contribute the public funds that are used to pay them.

(5) Article 15 (numeral 2), of the Sole Text of the Government Procurement Law, ordered by Law 153 of 2020, provides the following:

> "Competence. The duties of the General Directorate of Public Procurement are the following:.....
>
> 2. To dictate administrative acts that guarantees the application of this Law and its regulations.... "

In turn, article 26 of the Single Text of the Government Procurement Law, ordered by Law 153 of 2020, establishes:

> "Principle of Transparency. In compliance with this principle, the following rules will be observed:
> ...
> 3. The actions of the authorities **will be public** and the contractor selection processes will be open to **any interested person**. ..... "(the underlining is ours).

It seems very clear to us that:

- ... if the Government Procurement Legislation establishes that the information in the name of each individual who is directly or indirectly a "Final Beneficiary" must be delivered to the **DGCP**, when it is a company proposing or contractor of the State for amounts that exceed B/.500,000.00.
- ... if the Government Procurement Law acknowledges that it is part of the Principle of Transparency, the concept that "the actions of the authorities **will be public** and the contractor selection processes will be open to **any interested person** ..." (the underlining is ours).
- ... If the Government Procurement Law provides that the **DGCP** has the duty of “issuing administrative acts that guarantee the application of this Law and its regulations...”.

Consequently:

The information on whether the proponents and contracting parties have the "nominative" shares and the identity of their "Final Beneficiaries" (in bids with values greater than US$500,000.00), is **PUBLIC** and the **DGCP** is fully competent to dictate administrative acts that are necessary to share such information with any Panamanian citizen. It would be best if it is published on the website.

Final Comments

The evident vulnerability explained in the Government Procurement Law of Panama, in terms of the transparency of the "Final Beneficiaries" of the companies that contract with the State is not only a domestic problem, but is an additional link in the chain that affects our international image.

The international organizations that ensure compliance with transparency standards in all areas, probably calibrate this way of operating within Panama and I don't think it helps us much in our reputational issues.

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PUBLIO CORTÉS
ABOGADO - LAWYER

WWW.LEGALADVISORPANAMA.COM

M: +507 6679-4646 E: CORTES@LEGALADVISORPANAMA.COM

@PUBLIOCORTES.LAWYER