

Necessary reforms: Adaptation of insolvency regimes in Latin America

Carla Cervantes identifies how Latin American countries have attempted to remedy deficiencies in the laws in response to the COVID-19 pandemic



CARLA CERVANTES
Legal assistant, Estudio
Martinot Abogados, Peru

This article is a summary of the full paper written by the 2020 Richard Turton Award winner, Carla Cervantes from Peru.

As part of the award, Ms Cervantes will be invited to attend the INSOL Europe Annual Congress in Dublin (Ireland) in October 2021.

You can read the full version (also available in Spanish) of Ms Cervantes' award-winning paper on our website:
www.insol-europe.org/richard-turton-award



In the context of systemic crisis caused by the COVID-19 pandemic, insolvency regulation not only has to face the increase in the number of applications, but it also has to innovate and provide specific alternatives to the urgent refinancing needs of companies, such as modernising the proceedings in accordance with the limitations imposed by governments to stop contagion.

In response to this challenging scenario, governments have implemented different legal measures and Latin America has not been oblivious to these changes.

This article seeks to identify the main changes in insolvency matters in Latin American countries and how these have tried to remedy the deficiencies that existed before the COVID-19 pandemic.

Use of digital platforms

In Latin America, while there had been many previous attempts to introduce electronic procedures, the use of paper was by far the rule. As a reaction to the crisis, most countries in the region nowadays provide the option to follow the status of insolvency proceedings through online portals of their judiciaries,

including Brazil, Colombia, Ecuador, Chile, and Mexico, among others. Despite the fact that not all countries have access to electronic files, the creation of virtual channels for the submissions of applications and communication is now the general practice.

As an interesting case, it should be noted that Colombia has recently implemented online platforms, artificial intelligence and electronic forms created specifically to handle the large number of applications related to insolvency proceedings.¹

Regarding creditors' meetings, initially these were suspended during the COVID-19 lockdowns. However, most Latin



Colombia has recently implemented online platforms, artificial intelligence and electronic forms created specifically to handle the large number of applications related to insolvency proceedings



American jurisdictions now permit these meetings to be held through virtual platforms.

As for Brazil, there is no binding norm for the courts on this matter, but a series of recommendations were approved in connection with insolvency matters, including that virtual meetings shall be authorised when these are necessary to maintain the business activities of companies in reorganisation or for the beginning of payment to the creditors.² At this time, certain virtual meetings have been performed normally, but there has also been a case in which a virtual meeting was deemed unacceptable to creditors³.

Moreover, in Peru, virtual creditors' meetings and all the formalities for carrying them out within the framework of insolvency proceedings are regulated by a directive⁴.

Accelerated access to the insolvency proceedings

One of the specific problems in the countries of the region in insolvency matters is the delay to commence insolvency proceedings, as well as the effects of this upon debtor protection and in the approval of the reorganisation plan, problems that are exacerbated for the COVID-19 context. In such regard, the following changes have been adopted:

Changes in the ordinary proceedings

In Colombia, one amendment incorporated into the general insolvency regime is the relaxation of tests for the admission into a reorganisation procedure. As a consequence of this change, the judge will not seek to establish the content or accuracy of the financial documents provided by the debtor. On the admission resolution, the judge may also order the extension or updating of the information provided. This measure is temporary and streamlines the stages of the application process that previously took several months.⁵

Creation of fast-track insolvency process

The creation of special insolvency procedures has also been chosen as an exceptional solution for companies. These procedures are mainly characterised by their short-term, transitory nature and can only be submitted by those who have been affected by the emergency caused by the COVID-19 crisis.

In Latin American, Colombia and Peru are the countries that have special insolvency procedures in force to date. In Peru we have:

- The **“Expedited Insolvency Refinancing Procedure”**⁶ (PARC, for its initials in Spanish), it can only be initiated by debtors. The approval of the refinancing plan by the creditors' meeting generates its automatic application to all the creditors of the company, and never results in the partners or shareholders losing the administration of the debtor. Furthermore, the disapproval of the refinancing plan only generates the culmination of the procedure. In contrast to the ordinary regime where the approval of the refinancing plan can take between one to two years in the best of cases, in the PARC, once the request is admitted by the insolvency authority, the creditors' meeting is held within 55 business days. It should be noted that the burden of the insolvency authority to recognise labour and consumer debts has been removed in order to alleviate the great burden that the review of these applications represents and to meet the deadlines.⁷

In Colombia two fast-track insolvency procedures were created:

- **“Emergency negotiation of reorganisation agreements”**⁸ In this process, parties can reach an agreement in three months instead of six. It starts with a

notice of the debtor's intention to negotiate with the creditors and, based on this, the authority makes a formal review of the documentation submitted, admits the request and initiates the negotiation process. In this period, negotiations with groups of particularly vulnerable creditors are exceptionally allowed. The resulting agreement and the claims of dissidents are reviewed and in a single hearing the agreement is confirmed or not. Failure in negotiating the agreement does not produce the liquidation of the debtor, but rather the opportunity to process a reorganisation under the ordinary regime.

- **“Business recovery procedure”**⁹ This is a quasi-judicial procedure in which debtors can choose to file for this form of reorganisation at the Chambers of Commerce, where the mediator assumes the functions of the judge and has powers to verify the qualification and graduation of credits and determination of voting rights. The procedure lasts three months in order to enable the debtor and the creditors to reach the reorganisation agreement. With the conclusion of the payment agreement presented by the debtor, it may be submitted to the insolvency judge for validation in order to extend the effects of the agreement and decide on the objections and comments of the creditors.

Besides that, the pandemic makes micro, small and medium enterprises (MSMEs) especially vulnerable, and the use of insolvency mechanisms can be particularly costly for these companies.¹⁰ In view of this, in Colombia other expedited procedures were also incorporated, applicable only to companies whose assets are equal to or less than 5,000 monthly legal minimum wages in force:

- **“Abbreviated reorganisation process”**¹¹
From the beginning of this process, a date is set for a hearing that must be held within three months in order to reconcile objections to voting rights and the graduation of credits, and to present the agreement to the judge. Then there will be another hearing to resolve the unconciliated objections and confirm the agreement.
- **“Simplified judicial liquidation proceedings”**¹²
In this procedure, the time within which creditors must submit their claims is reduced from 20 to 10 days, after which the liquidator has two months to sell the assets to third parties or to the creditors who may make offers. If not all the assets are sold, an adjudication project is submitted to the Judge for allocating them to the creditors.

Mechanisms to help debtors in insolvency proceedings

Certain interesting measures were included to help and protect debtors in insolvency proceedings. Especially in Colombia, within the legislative package in insolvency matters³, some of these are the following:

- **Rescuing companies in imminent liquidation status:** In the event that the end of the reorganisation process has been declared and the start of the liquidation process has been ordered, any creditor may prevent the liquidation by providing new funds that cover at least all payable credits, as long as the patrimony of the debtor is negative and the creditor deposits the total cost of the operation.
- **Tax benefits:** Companies that are in reorganisation processes can access exemption benefits on different taxes. Likewise, there is the possibility that the Colombian tax authority

negotiates and cancels debts such as penalties, interests and even principal.

- **Incentives for DIP financing:** The obligations resulting from new financing provided between the beginning of the reorganisation process and the confirmation of the reorganisation agreement shall be preferred over the creditors’ claims in the restructuring process and the authorisation from the judge will not be required.
- **Extension of payment terms:** Quotas of the reorganisation agreements in execution corresponding to the months of April, May and June 2020 were not considered due until July 2020.
- **Breach of the reorganisation agreement:** The reorganisation agreement will not terminate if an event of default of the obligations of the agreement occurs unless the breach extends for more than three months and is not remedied by the hearing.

Regarding the obligations of the reorganisation plans, the following recommendations have also been adopted in Brazil¹⁴:

- **Impossibility of executing the debtor’s assets:** The judge must evaluate with exceptional caution granting measures of eviction due to lack of payment and enforcement acts of an equity nature in claims that demand the fulfilment of defaulted obligations during the state of emergency.
- **Modifications to the reorganisation plan:** The judge must authorise the presentation of any modification of the reorganisation plan, when the decrease in the capacity to fulfil obligations due to the COVID-19 pandemic is proven and if the current plan was being complied with by 20 March 2020.

Closing remarks

With the arrival of the crisis generated by COVID-19, insolvency regimes had to face new problems such as the increase in insolvency applications, urgent refinancing needs of companies and the limits of the provisions issued to stop the expansion of the virus.

Thus, the laws have had to adapt to these new times and some governments have taken the opportunity to implement extraordinary measures for corporate rescue and make their procedures more flexible. Brazil, Chile and Mexico are some of the countries that are already working on reform projects.

Some of these measures are here to stay and, in any case, the implementation of these new formulas will provide the necessary knowledge to establish whether these allow to solve both temporary and systemic problems in the regulation. ■

Footnotes:

- 1 Article 3 of Legislative Decree No. 772 of June 3, 2020. Likewise, recently the Superintendent of Companies created a digital tool called Insolvency Module (MI), which incorporates the technological tools indicated by de Legislative Decree for insolvency proceedings.
- 2 Article 3 of Recommendation No. 63 of March 31, 2020.
- 3 In the case of Cultura (Process No. 1110406-38.2018.8.26.0100) the virtual meeting was rejected by the court on the ground that it would cause difficulties for labor creditors to attend or to be represented in the meeting.
- 4 Directive N° 001-2020-DIR-COD-INDECOPI of May 24, 2020.
- 5 Article 2 of Decree No. 560 of April 15, 2020 and Decree No. 772 of June 3, 2020. In Colombia, insolvency proceedings can be initiated before a judge or before an administrative authority that exercises jurisdictional functions: the Superintendent of Companies. In this country, virtual procedures were already operating prior to the COVID-19 pandemic, mainly for procedures carried out by the Superintendent of Companies.
- 6 Legislative Decree No. 1511 of May 11, 2020 and its regulations Supreme Decree No. 102-2020-PCM of June 7, 2020. Debtor companies may only request acceptance to this procedure until December 31, 2020.
- 7 Article 8 of Legislative Decree No. 1511 of May 11, 2020. In compensation, the decree provides that at least 40% of the funds or moneys allocated annually for the payment of claims must be allocated to labor claims and 10% to consumer loans.
- 8 Article 8 of Decree No. 560 of April 15, 2020.
- 9 Article 9 of Decree No. 560 of April 15, 2020.
- 10 For more detail about the impact of the COVID-19 crisis on MSMEs, including MSME insolvency, see: <http://pubdocs.worldbank.org/en/879461586478617078/COVID-19-Outbreak-Support-to-Firms.pdf>
- 11 Article 11 of Decree No. 772 of June 3, 2020.
- 12 Article 12 of Decree No. 772 of June 3, 2020.
- 13 Decree No. 560 of April 15, 2020, Decree No. 772 of June 3, 2020 and Decree No. 842 of June 13, 2020.
- 14 Recommendation N° 63 of March 31, 2020.



The laws have had to adapt to these new times and some governments have taken the opportunity to implement extraordinary measures for corporate rescue and make their procedures more flexible

