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Enhanced credit protection

Crucial steps are being taken by Panama's government to improve its insolvency framework. The outcome should benefit foreign investors

The inauguration of the new $5.25 billion Panama Canal locks, the estimated $500 million expansion of the Tocumen International Airport and the $1.8 billion and $2 billion procurements of lines two and three of the metropolitan subway system, respectively, are some of the highlights of what appears to reflect the IMF's view that Panama's outlook is favourable. The country has had the highest average growth in the region over the past decade (Ibid). Part of this growth might be attributed to the country's commitment to becoming competitive by way of its continuing adoption of business-friendly legislation. As stated by the World Bank Group, Panama City is ranked as the city with the best regulatory practice for doing business in the region (Doing Business in Central America and the Dominican Republic, The World Bank Group, 2015).

Although Panama's regulatory regime is business friendly, the World Bank has identified a particular area of concern: its insolvency framework ('Resolving Insolvency in Panama', Doing Business, The World Bank Group, June 2015). Most importantly, before 2016, this concern partly rested on the lack of a Chapter 11-type of reorganisation applicable to companies outside the scope of the insurance, banking or securities regulators. The importance of credit protection in Panama by way of a modern insolvency framework cannot be overstated: the projects referred to in the previous paragraph are just a few of the many projects recently financed through foreign capital.

Credit protection is an important factor for Panama and its competitive environment, especially if foreign investment is to continue to play a major role in its economic growth, as suggested by a government minister, when introducing the new liquidation and reorganisation bill in 2016 ('*Presentan ley para evitar que empresas con dificultades económicas cierren*' *La Prensa*, January 28 2016). The same minister pointed out that Panama is one of the few countries in Latin America not to have a reorganisation framework for companies that sought temporary protection from the courts for purposes of reaching an agreement with creditors and continuing business. Here, we will provide an overview of the reorganisation process introduced under Law 12 of 2016.

The reorganisation process

The scope

Law 12 of May 19 2016 governs insolvency proceedings in Panama and its main objective is credit protection. It provides two mechanisms for credit protection: (i) a reorganisation process aimed at enterprises that may be facing economic difficulties; or, (ii) a judicial liquidation process aimed at inefficient enterprises. The reorganisation process may be requested and initiated out of an existing judicial liquidation process. Here, we will focus only on the reorganisation process, given its novelty in the country's jurisdiction. The scope of the Law 12 insolvency regime is broad; it includes any natural or legal persons that may have its/their commercial domicile, branch, agency or establishment in the Republic of Panama, regardless of whether that person is registered in the Panamanian public registry. The reorganisation process does not cover, however, public entities, companies wholly-owned by the government, and entities regulated by the bank, insurance and securities regulators; the latter are already subject to each relevant regulator's specific reorganisation processes.

The start of a reorganisation process

A reorganisation process may only be requested before the insolvency courts by a debtor, the creditors' committee, or foreign insolvency proceedings. In this article, we will focus only on the requests made by the debtor and the creditors' committee. The reorganisation process only applies to a debtor that falls within one of the following three categories: (i) suspension of payments, (ii) imminent insolvency, or, (iii) a foreseeable lack of liquidity.

A reorganisation request made by the debtor requires that the debtor files, from the outset, a draft reorganisation plan, which includes the financial, organisational, operational and competition restructuring plan designed to overcome a suspension of payments, imminent insolvency or foreseeable lack of liquidity. Once the request is filed by the debtor, the judge reviews the grounds and formalities under the request made by the debtor and then rules upon the request and orders, where applicable, by way of a court resolution to commence the reorganisation process.

The foregoing resolution provides the following, for purposes of establishing or granting the basic elements going forward in the reorganisation process: (i) the appointment of an insolvency administrator, (ii) the granting of insolvency protection, as further discussed below, (iii) the debtor is ordered not to perform certain acts, *inter-alia*, those described in the paragraph below, (iv) the issuance of an injunction, if applicable, with respect to the debtor's assets, and, (v) the mandating the announcement of the reorganisation process via multiple means contained in Law 12, which might include informing foreign creditors by alternative means.

The immediate effects of the filing

From the date the reorganisation process request is filed before the insolvency courts, the debtor effectively loses major control over its enterprise, except for acts that take place through the ordinary course of business. At the corporate level, no amendments to the articles of incorporation or by-laws of the debtor may be made and, at the enterprise level, *inter-alia*, no contracts, transactions, guarantees, payments, terminations, waivers or disposals may be made or entered into, as the case may be, by the debtor. The definition of 'ordinary course of business' under Law 12 is, in general terms, those operations made by the debtor in accordance with its business practices before being subject to the insolvency proceedings. Renewable contracts, in particular, are regulated by Law 12. Those contracts may be renewed by the debtor by way of mutual agreement with its respective counterparty, but if no mutual agreement is reached, the insolvency court may authorise the termination of the contracts if the obligations that would be imposed by the counterparty on the debtor are excessive – that excessiveness being as determined by the insolvency court.

The creditor is further protected against acts not deemed to be in the ordinary course of business by a provision in Law 12 which permits the insolvency courts to declare void any act by the debtor which violates the prohibitions mentioned above. Furthermore, the insolvency courts are allowed to remove the responsible parties and demand compensation from those parties. Creditors may also pursue other remedies under Panamanian law against those responsible for violating the prohibitions.

Insolvency protection

The court resolution ordering the commencement of the reorganisation process carries insolvency protection in favour of the debtor, which will remain in force until a reorganisation agreement is confirmed by the insolvency court. During this period, the debtor may not be subject to foreclosure on its assets or similar proceedings, may not constitute mortgages or have its mortgages executed, and the statute of limitations applicable to the debtors' proceedings becomes temporarily suspended. The debtor's contracts are mandated to remain in force with their respective terms and conditions unchanged and the counterparties may not enforce an early termination of, or enforce rights under, those contracts solely based on the grounds that the debtor is subject to a reorganisation process. The foregoing implies that Law 12 does not permit defaults to be enforced based on the fact that a reorganisation process has begun. This insolvency protection also applies to government contracts and prohibits government entities from suspending the debtor from contracting with the government.

Credit recognition

After the court resolution is issued, creditors have up to 20 days to file before the insolvency court the documents evidencing their respective credits for verification purposes. In this filing, each creditor may adhere, comment and propose changes, to the debtor's proposed reorganisation plan. The filing by the creditor also requires a sworn statement indicating the creditor's relationship *vis-a-vis* the debtor, including family ties or any type of common interest.

The credit documents filed for verification purposes have one of two outcomes: either they are verified or they receive an objection. In the case of the latter, there are four verification stages. The first stage is performed by the insolvency administrator once the previously mentioned 20-day filing period expires. The second stage is performed by the creditors and the debtor once the insolvency administrator has either verified or objected to each credit within the first stage. After this second stage, the credits that did not receive an objection are deemed verified and the insolvency court proceeds to call the first creditors' committee meeting. The third stage occurs once the creditors' committee meeting is convened. During this meeting the creditors' committee may verify and accept the credits that previously received objections. If the credits also receive objections at this third stage, an appeal may be made by the creditors before the insolvency court as the fourth stage.

The insolvency administrator, at his/her discretion, has the option to propose to the insolvency court that the reorganisation process be terminated if the credits receiving an objection represent an obstacle to the efficient reorganisation of the debtor, due to their amount or any other particular aspect. The consequences of the termination are further explained below.

Meeting and approval

The creditors' committee meeting takes place as called by the insolvency court after the second stage described above. At that meeting, only the credits that have been verified are allowed to vote, and an absolute majority of them is required to constitute a quorum. In this first meeting, the creditors' committee discusses the debtor's proposed reorganisation plan, as well as the comments and amendments proposed by the creditors. The discussion is aided by a presentation by the insolvency administrator with respect to the financial conditions of the debtor and the insolvency administrator's opinion on the viability and content of the debtor's proposed reorganisation plan.

The reorganisation agreement is mandated to cover all verified credits, and to take into account the preference, priority and privileges mandated by law with respect to each credit. The reorganisation process permits flexibility with the type of reorganisation arrangements, by allowing the constitution of securities over the debtor's assets for purposes of carrying out the reorganisation plan. The creditors' committee also designates two key persons: (i) an administrator in charge of the execution of the reorganisation plan, who should replace the insolvency administrator in cases where the insolvency administrator is not chosen to execute the plan, and, (ii) the supervisor of the execution of the reorganisation plan. Both of these persons have the duty to file before the insolvency court a monthly report on the status of the reorganisation plan and to provide relevant updated information to the creditors. The creditors' committee and the administrator may alert the insolvency court of alleged violations to the reorganisation plan and may request the court to take appropriate action.

The approval of the reorganisation agreement requires the consent of creditors that represent at least 66% of the total liabilities of the debtor; provided, that, if more than half of the debtor's liabilities are held by related-party creditors, then two subsequent voting procedures will take place. One voting procedure takes place only with related party creditors and the other voting procedure only with non-related party creditors. In this parallel voting situation, the approval requires the consent of the creditors representing at least 66% of the liabilities corresponding to each group of creditors (that is, related-party and non-related party creditors). If the reorganisation agreement is not approved at this first creditors' committee meeting, then a negotiation process begins between the creditors, the debtor and the insolvency administrator, for the purpose of reaching an agreement on a reorganisation plan, within a limited time period.

The reorganisation agreement, once approved by the creditors' committee, is also subject to a final approval by the insolvency court, whose approval depends on whether: (i) the appropriate creditors' approval has been obtained, (ii) the appropriate procedure has been followed, and, (iii) the content of the reorganisation plan is legal. The approved reorganisation agreement binds all creditors, whether or not they have appeared before the creditors' committee meeting.

Failure to reach agreement

The reorganisation agreement may be terminated by way of: (i) the insolvency court's decision upon recommendation from the insolvency administrator, (ii) a lack of agreement by the creditors' committee on a reorganisation plan, (iii) a majority decision by the creditors' committee to terminate the process, or, (iv) a successful fulfilment of the reorganisation plan, as confirmed by the insolvency court. In the termination cases (i) to (iii) where the reorganisation plan was not successfully executed, there are two outcomes: if liquidation proceedings were halted for purposes of allowing a reorganisation process, then the liquidation proceedings will continue. If no liquidation proceedings were taking place, any creditor or the creditors' committee may request the liquidation of the debtor, if applicable under Law 12.

The challenge of the process

Although this article is limited to a brief summary of the reorganisation process, in our view, the main foreseeable challenge of the reorganisation process might be the newly created insolvency courts. The challenge is two-fold: (i) the courts are required to act within the mandated time frames, and, (ii) the judges and related personnel require a sufficient understanding of economic and financial matters related to the reorganisation of an enterprise. With respect to the former, Law 12 suggests that an efficient process takes approximately 47 days from the day the reorganisation process is requested to the day the reorganisation plan is approved and confirmed by the court. This minimum time frame assumes that (i) the end date of each deadline ends on a Panamanian business day, (ii) each party acts on the maximum allotted time, and, (iii) there are no objections to the credits or filings that may delay the process. The 47-day period starts from the moment the reorganisation process is requested, followed by: (i) five days, in which the insolvency court reviews the request and issues the resolution ordering the commencement of the reorganisation process, (ii) five days, during which the insolvency administrator has to coordinate the publication of the foregoing resolution, (iii) five days, during which the resolution is published daily, (iv) 20 days, during which the creditors file their credits for review before the insolvency court, (v) two days for the first stage verification process by the insolvency administrator, (vi) five days, during which the insolvency court has to call the first creditors' committee meeting, (vii) five days, during which the insolvency administrator has to publish a list of the results of the second stage verification process by the creditors and debtor, and, (viii) 10 days to convene the creditors' committee meeting in which the reorganisation plan can be approved.

The insolvency courts would have to prevent the build-up of a backlog of cases or other delays that have characterised certain other courts in Panama ('*La Mora Judicial y la Aplicación de los Métodos Alteros de Solución de Conflictos*' Morrison Campos. *A, Boletín de Información Jurídica No. 44, Universidad de Panamá*, 2010. With respect to the latter challenge, an IMF working paper has identified bankruptcy law in Central America to be affected by 'a lack of expertise of bankruptcy judges in economic and financial matters, all of which result in lengthy and somewhat unpredictable proceedings' ('Equity and Private Debt Markets in Central America, Panama, and the Dominican Republic', page 23, Shah, H *et al*, IMF Working Paper 2007). Given the novelty of this type of court in the country, the limited resources that the central government allocates to the judicial system according to the former president of the Supreme Court, Harley Mitchell, and possible delays in the appropriate implementation of reforms, as evidenced by the two-year delay in other important judicial reform such as the criminal adversarial system, it is of the utmost importance that the necessary budget allocations and sufficient investment are made to provide the capacity of personnel to be able to achieve the level of credit protection that Law 12 wishes to achieve ('Mitchell *aboga por más presupuesto para el Órgano Judicial*', *La Prensa*, December 29 2015, and '*Sistema penal acusatorio, en aprietos de dinero*', *La Prensa,* February 21 2016).

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