Dispute Resolution Guide 2016

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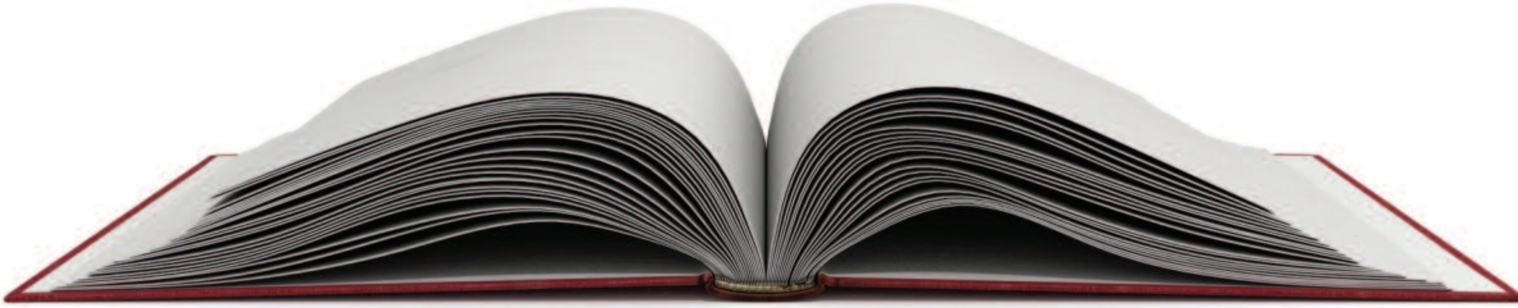

Creditors' new handbook

Claudio De Castro of **Arias Fábrega & Fábrega** sets out his top tips for creditors trying to collect under the new bankruptcy law

After 100 years, Panama has enacted new bankruptcy legislation, Law no. 12 of May 19 2016 (the new bankruptcy law). It will enter into force on January 2 2017 and is based on the UNCITRAL Legislative Guide on Insolvency Law, as well as legislation from Colombia, Chile, Argentina, the US, Peru and Spain. All bankruptcy proceedings filed before January 2 2017 will continue to be regulated by the provisions of the Code of Commerce of 1916 (the 1916 bankruptcy law).

It is vital for creditors to know how the new bankruptcy law might affect or improve their chances of collecting their credit from a company undergoing bankruptcy proceedings in Panama.

Participate in reorganisation proceedings

The 1916 bankruptcy law was based on the idea of sanctioning the defaulting debtor as well as liquidating the company and distributing all of the debtor's assets among its creditors. Therefore, it did not include the possibility of reorganisation proceedings. Once a creditor was declared bankrupt, they would immediately enter into liquidation proceedings. Thereon, all of their pending obligations became due; their assets were set aside; an administrator was appointed; the bankrupt party's communications and mail was withheld; creditors were requested to submit their credits to the bankruptcy court for review by the administrator; and a meeting of creditors was called.

In contrast, the modern provisions of the new bankruptcy law are based on the idea of protecting the credit and the survival of any business in difficulties. Therefore, reorganisation proceedings are now possible to attempt to save companies in economic difficulties and avoid liquidation proceedings.

Reorganisation proceedings can be requested by either the debtor itself, by a creditor's assembly formed within liquidation proceedings, or by the representative of foreign bankruptcy proceedings.

> It is important for creditors to work with their debtor

For the bankruptcy court to allow the proceedings, the requesting party must submit a draft reorganisation plan (the plan), which must include a proposal for the financial, organisational and operational restructuring of the debtor. The plan must aim to provide a concrete solution to the problems that have caused the lack of payment and insolvency of the debtor.

It is important for creditors to participate in the reorganisation proceedings so that they can ensure that, as far as possible, the plan protects their interests. To be allowed to participate, creditors have to file their credit with the bankruptcy court within 20 working days after the last publication in a local newspaper of a notice informing the public of the debtor's reorganisation. It is vital for creditors to file their submission with the court within this period since no additional creditors will be allowed to participate after this period has elapsed.

Creditors participating in the proceedings will have 10 business days after the first creditors' meeting (which can be extended for another 20 business days) to review and make changes to the draft plan submitted to the bankruptcy court. These proposed changes will be discussed with the debtor and the trustee appointed by the court. Within this time period, the parties must agree on a final version of the plan, which the appointed trustee will submit to the court for the approval of the creditors that have been allowed in the proceedings. The plan must be approved by a supermajority of the participating creditors, which represent at least 66% of the total debt.

An actively participating debtor is more likely to protect their interests in the proceedings (particularly if they are an unsecured creditor).

Work with the debtor

Under the 1916 bankruptcy law, the insolvent debtor was alienated from their assets and business. Under the new bankruptcy law, they are now allowed to participate in the reorgansation proceedings and propose a plan to save their business. Therefore, it is important for creditors to work together with their debtor within the reorganisation proceedings to reach mutually acceptable solutions and come up with a plan that will be approved by the required majority of creditors, to avoid liquidation.

The approval of the plan is beneficial for the insolvent debtor as well as for its creditors. On the one hand, the insolvent debtor has the possibility of saving their business and avoiding the consequences of liquidation (which includes criminal liability in the case of a fraudulent bankruptcy). On the other hand, creditors (especially unsecured creditors) are more likely to collect a higher amount of their credit under reorganisation proceedings than under liquidation proceedings.

> **Unsecured creditors usually only recover a small percentage of the credit**

It is important for unsecured creditors to be flexible and to keep in mind that it will be almost impossible for them to recover the entire amount of the debt. Flexible creditors are more likely to reach an agreement regarding the plan, which will avoid entering into liquidation proceedings.

As far as possible, creditors should avoid opening liquidation proceedings against the insolvent party. As previously mentioned, under these proceedings unsecured creditors usually only recover a small percentage (if any) of their credit. This is why creditors were reluctant to request the bankruptcy of a company in Panama under the 1916 bankruptcy law. It is also the reason that courts were sometimes reluctant to grant such a request.

Don't rule out liquidation proceedings

Unsecured creditors are likely to collect a higher amount of their credit under reorganisation than under liquidation proceedings. However, although a creditor can request the opening of liquidation proceeds, a creditor, by themselves, cannot request the opening of reorganisation proceedings. Since reorganisation proceedings can be transformed into liquidation proceedings and *vice versa*, one way for a creditor to push for the reorganisation of the debtor is to request the opening of liquidation proceedings. Once these proceedings have been allowed, either the debtor themselves, the creditor's assembly or the representative of foreign bankruptcy proceedings, can request that the proceedings be converted into reorganisation proceedings.

Moreover, in liquidation proceedings, unsecured creditors have ways of collecting their credit from third parties, as explained below. Therefore, creditors don't necessarily have to exclude the possibility of filing for the liquidation of their debtor.

Beware of your collateral

The 1916 bankruptcy law did not include any provisions that would limit the secured creditor's right to enforce their collateral. Indeed, secured creditors would enforce their collateral as soon as a declaration of bankruptcy was issued.

In contrast, under the new bankruptcy law, secured creditors cannot initiate foreclosure proceedings to enforce the pledges or mortgages granted by the insolvent debtor, while reorganisation proceedings are in place. Moreover, the foreclosure proceedings already initiated will be stayed until the reorganisation has concluded or six months after it has been initiated (whichever occurs first).

Once secured creditors are allowed to enforce their collateral, it is advisable for this enforcement to be done in separate proceedings. Secured creditors can choose between enforcing their collateral within the insolvency proceedings before the bankruptcy court, or enforcing them separately before ordinary courts. In most cases, enforcing collateral before ordinary courts is faster and less complicated.

Beware, landlords

The 1916 bankruptcy law did not include any provisions that would limit the landlord's rights to evict the insolvent party. Under the new bankruptcy law, landlords cannot evict the insolvent debtor from their place of business for unpaid rental fees owed before the reorganisation proceedings started, while these proceedings are in place. However, landlords can evict the insolvent from their place of business if they fail to pay the rent due following the initiation of the reorganisation proceedings.

Take note of court costs

The 1916 bankruptcy law did not require the creditor requesting the involuntary bankruptcy of the insolvent party to pay any expenses. All expenses connected to the bankruptcy (such as the fees of the trustee appointed by the court) were covered with monies of the insolvent party.

Under the new bankruptcy law, the party requesting the bankruptcy proceedings must now post the initial costs of the liquidation proceedings ($1,000), plus the payment of the provisional monthly salary of the liquidator. This is set at $3,000 and is subject to modification by the assembly of creditors.

Equal treatment of creditors

Under the 1916 bankruptcy law, creditors residing in Panama had a preference over foreign creditors. Foreign creditors could only collect their credit once creditors residing in Panama had been paid.

Under the new bankruptcy law, local and foreign creditors participating in the proceeding are treated equally and have the same rights. This is a considerable advantage for foreign creditors, whose chances of collecting in Panama are significantly increased under the new bankruptcy law.

Foreign bankruptcy declarations

The 1916 bankruptcy law allowed the recognition and enforcement of foreign decisions declaring a bankruptcy. However, obtaining this recognition and enforcement was not easy. The requesting party had to file the request before the Fourth Chamber of the Supreme Court of Justice and the representatives of foreign bankruptcy proceedings were not expressly allowed to file such request in Panama.

The recognition of foreign bankruptcy proceedings is easier under the new bankruptcy law. Firstly, this recognition does not have to be requested from the Fourth Chamber of the Supreme Court of Justice. Rather, it is requested from a lower and less formalistic court, which specialises in bankruptcies: the newly-created Fourth Superior Tribunal. Secondly, the new bankruptcy law expressly mentions that the representatives of foreign bankruptcy proceedings are not only entitled to request in Panama the recognition and enforcement of foreign decisions declaring a bankruptcy, they can also request the opening of reorganisation or liquidation proceedings in Panama. Finally, within the recognition proceedings the court can issue interim measures to protect the insolvent party's assets.

Third party liability

The 1916 bankruptcy law did not include any clear provisions regarding third party liability, other than criminal liability of anyone who participated in fraudulent transactions by the insolvent party.

In contrast, under the new bankruptcy law, anyone who benefited from acts committed in prejudice of creditors and which have been declared null and void, are personally and proportionately liable. If the person who benefitted from those acts is a legal entity, its managers, administrators, directors, officers, legal representatives, liquidators, agents, partners or shareholders, who benefitted indirectly, are also liable. This is a major new advantage for creditors, who now have additional options for collecting their credit.

Attaching assets

The 1916 bankruptcy law did not include any clear provisions regarding the liability of the persons behind an insolvent company, other than criminal liability in the case of a fraudulent bankruptcy.

Under the new bankruptcy law, once the liquidation of a company is declared, any creditor can request the seizure or attachment of the assets of the directors, legal representatives, managers, agents, or auditors of the insolvent company, or any person that might have committed negligent or fraudulent acts against the creditors of the company.

Attaching or seizing assets (ie, receivables, bank accounts, real estate properties) in Panama is a precautionary measure decided *ex parte* that aims to ensure the results of a judicial proceeding. For an attachment to be granted, the creditor does not have to provide *prima facie* evidence of their claim. They are only required to post a security bond (in the form of cash, bonds of the Republic of Panama, bank or insurance guarantees). The amount is established at the court's discretion but is usually between 30% to 40% of the amount requested to be seized.

After posting the security bond, the court will proceed to grant the request for seizure. If a final judgment is rendered in favour of the defendant, it can request the amount of the bond as payment of the damages suffered as a result of the attachment. If the defendant does not claim damages after three months following the issuance of the final and binding decision rejecting the claim, the bond will be returned to the creditor who requested the attachment.

> **Local and foreign creditors are treated equally**

The possibility of attaching assets of these persons also represents a major advantage for unsecured creditors, who can use this interim measure as a way to prevent the potentially liable parties from diluting their assets. Therefore, the new bankruptcy law increases the likelihood that unsecured creditors will collect.

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About the author

Claudio De Castro has been an associate at the firm since 2011. He specialises in representing foreign clients and multinational companies that are facing complex arbitration or litigation proceedings in Panama or involved in multi-jurisdictional disputes that include a Panamanian component.

He developed his international experience working as trainee in the international arbitration departments of Shearman & Sterling in Paris (2010) and Wilmer Cutler Pickering Hale and Dorr in London (2010-2011). He has also participated as an arbitrator in the Willem C. Vis international commercial arbitration moot in Vienna.