

Can Colombian Trusts Serve as Bankruptcy Remote Vehicles?

By PAOLA GUERRERO and JUAN CARLOS PUENTES



There is a common question raised by creditors undergoing internal credit approval for a financing transaction taking place in Colombia: can we achieve bankruptcy remoteness by way of a trust? Before 2014, the answer was plain and simple as the only trusts that could offer bankruptcy remote features were (1) those acting as issuers of securitizations in the stock exchange market and (2) collateral trusts backstopping the issuance of securities placed through the stock exchange.¹ However, beginning with the 2014 decision in the *Campollo S.A.* case through the 2018 and 2019 decisions in the *Organización Suma S.A.S.* case, the Colombian Superintendence of Companies (the “**Bankruptcy Court**”) has issued a line of case law in reorganization proceedings (similar to U.S. Chapter 11 proceedings) that appears to establish certain objective criteria that extend features of bankruptcy remoteness to trusts that act as direct and main borrowers in financing transactions. With respect to liquidation

proceedings (similar to U.S. Chapter 7 proceedings), the case law is less established; however, as of the enactment of Law 1676 of 2013, assets of collateral trusts that are created prior to the initiation of liquidation proceedings are deemed to be excluded from a debtor’s liquidation estate subject to certain limitations. This article briefly describes the “principle of universality” set forth under Law 1116 of 2006 (“**Law 1116**”) and recent case law that addresses the question of whether Colombian trusts can serve as bankruptcy remote vehicles and, therefore, fall outside the scope of such principle of universality.

The principle of universality is one of the corner stones of the Colombian bankruptcy regime as it purports to create in the context of bankruptcy proceedings the necessary bond between the debtor’s assets and its creditors. In light of this principle, the Bankruptcy Court has rendered several rulings

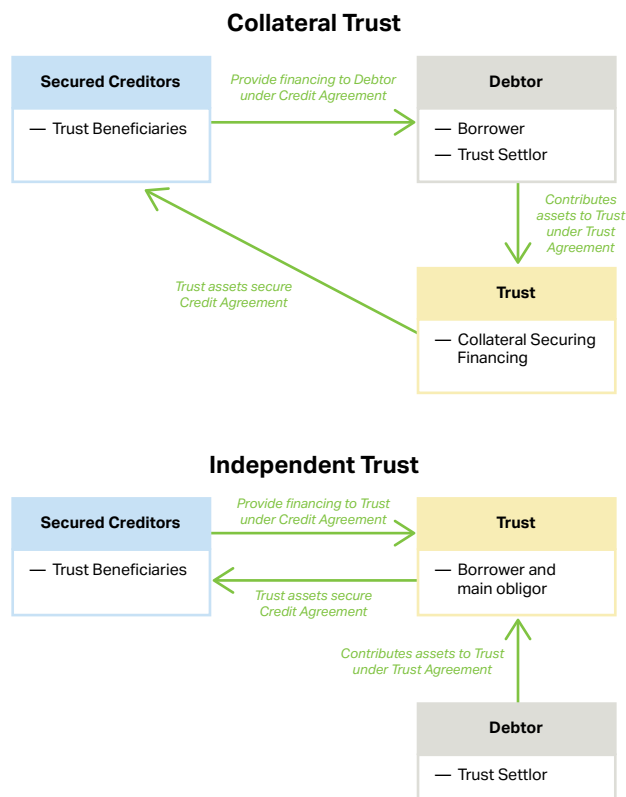
specifying certain rules with respect to trusts that are based on the type of bankruptcy proceeding. Thus, depending on the type of bankruptcy proceeding, the ability of creditors to use trusts as vehicles to bypass the scope of the principal of universality may vary.

The insolvency regime in Colombia is divided into reorganization and judicial liquidation proceedings. The goal of reorganization proceedings is to (1) promote the viability of a business through the restructuring of the debtor's assets and liabilities and (2) stabilize a debtor's existing commercial and credit relations through operational, financial and administrative restructurings. The goal of judicial liquidation proceedings, on the other hand, is to compensate a debtor's creditors in a prompt and orderly fashion through the assignment or sale of the debtor's assets, either by virtue of a direct sale, or private or public auctions.

Trusts in reorganization proceedings

In reorganization proceedings, upon filing of the admission request before the Bankruptcy Court, the debtor's assets become subject to an automatic stay under Article 17 of Law 1116. Pursuant to the automatic stay, a debtor is barred from (1) paying debts that exceed its ordinary course of business or (2) entering into agreements with creditors related to pre-reorganization claims, set-off obligations or the creation or enforcement of any type of security over its assets, in each case without the Bankruptcy Court's prior written approval. Moreover, creditors are prevented from commencing collection actions for pre-reorganization debts, as well as from initiating or continuing any collection proceedings or foreclosing on the debtor's property.

With respect to the application of both the automatic stay and the principle of universality in reorganization proceedings, the Bankruptcy Court has drawn a distinction between two types of trusts. The first is a trust that serves as a security interest in favour of a beneficiary who at the same time is a creditor of the trust settlor ("**Collateral Trusts**"). The second is a trust that holds funds directly transferred to such trust by creditors in connection with a financing transaction; in this context, the trust acts as the direct borrower and main obligor under the financing documents ("**Independent Trusts**").

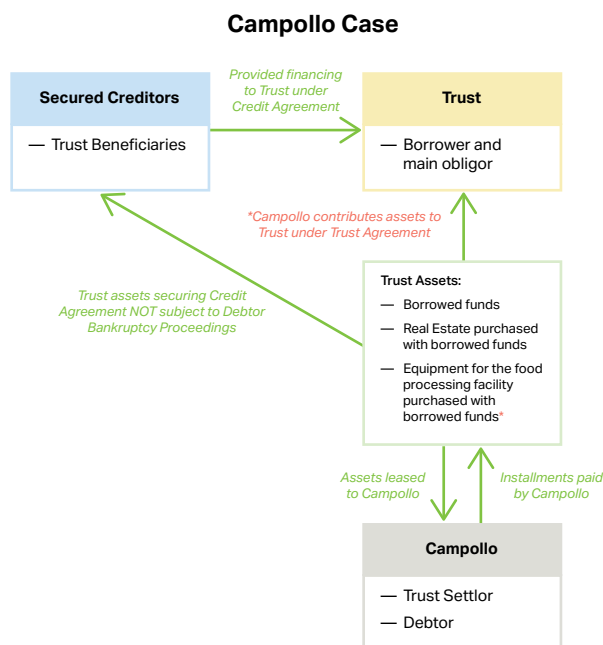


Based on the principle of universality and the rules governing automatic stays, the Bankruptcy Court has limited the effectiveness of Collateral Trusts in the context of reorganization proceedings, preventing the trustee from paying beneficiaries outside the scope of the trust settlor's bankruptcy proceedings. The Bankruptcy Court's rationale for this such action is based on the idea that Collateral Trusts are not entities separate from the insolvent trust settlor; therefore, the Bankruptcy Court considers the assets of the Collateral Trust to be a part of the trust settlor's bankruptcy estate, which is subject to the automatic stay under Law 1116, and the trust beneficiaries to be creditors of the settlor (rather than of the trust itself). As a result, as a general rule, beneficiaries of Collateral Trusts must participate as creditors in the settlor's reorganization proceedings.²

The Bankruptcy Court, however, has recently issued a line of decisions that seemingly creates an exception from the general universality rule for Independent Trusts, such that Independent Trusts are separate from a trust settlor's reorganization proceedings. In each case, the Bankruptcy Court weighed certain factors related to the trust agreement to determine whether the automatic stay and the principle

of universality applied to the trust in question, which included (i) the purpose of the trust agreement, (ii) identity of the trust settlor, (iii) identity of the trust beneficiaries, (iv) the nature of the assets contributed to the trust, and (v) the nature of the obligations paid by means of the trust (i.e., if the trust was the principal obligor).

The Bankruptcy Court’s first ruling in this line of cases was issued in the Campollo S.A. (“**Campollo**”) reorganization proceeding.³ In this case, Campollo, as the settlor, set up a trust that served as the borrower in a credit agreement entered into between the trust and certain financial creditors. The trust then used the funds from the credit agreement to purchase real estate to build and develop a food processing facility. The trust then leased the real estate and the food processing facility to Campollo, the settlor, to improve Campollo’s channels of distribution and sales capacity. Upon commencement of Campollo’s reorganization proceedings, based on automatic stay provisions under Law 1116, Campollo requested that the Bankruptcy Court (i) order the trustee to transfer the trust’s funds, both present and future, to the Campollo estate and (ii) prevent the trustee from paying pre-filing debts of Campollo, specifically those in favour of the creditors under the credit agreement.



In reaching its decision, the Bankruptcy Court analysed the purpose of the trust agreement and found that the trust was set up to pay and secure the trust’s own obligations,

specifically its obligations under the credit agreement. Consequently, the Bankruptcy Court held that the trust beneficiaries were in fact the financial creditors that extended credit to the trust, and that the following assets belonged to the trust: (i) the funds borrowed by the trust in connection with the credit agreement, (ii) the real estate purchased with the borrowed funds, (iii) the economic rights to the revenues of the Campollo commercial establishments along the Caribbean coast, (iv) the instalments paid by Campollo to the trust in connection with the lease agreement between the trust and Campollo, and (v) the equipment contributed by Campollo to the food processing facility.

Overall, the Bankruptcy Court rejected Campollo’s requests and held that the automatic stay under Law 1116 and the principle of universality did not apply to the trust given that the trust’s assets were part of the trust’s estate and that the trust entered into the credit agreement as the direct and main obligor (*deudor principal*);⁴ therefore, the Bankruptcy Court held that the payment waterfall under the trust agreement had to be respected and would not be affected by the settlor’s reorganization proceedings. Thus, pursuant to the trust’s waterfall, the funds were to be applied first to any trust expenses, second to service the debt of the financial creditors and, finally, with respect to the remaining proceedings, as a distribution to the trust settlor.

The second ruling in this line of cases was issued in the Central Papelera de Colombia S.A.S. (“**Central Papelera**”) reorganization proceeding.⁵ In this case, the trust settlor, Central Papelera, set up a trust to obtain the approval of two lines of credit with the bank Banco Colpatría Multibanca Colpatría S.A. (“**Colpatría Multibanca**”), which funds would in turn be used by the trust to: (i) purchase receivables and inventory from the settlor and the settlor’s suppliers to sell them to clients, and (ii) perform foreign exchange transactions. Similar to the Campollo case, the trust executed the credit agreement as borrower and received the proceeds directly from the lenders.

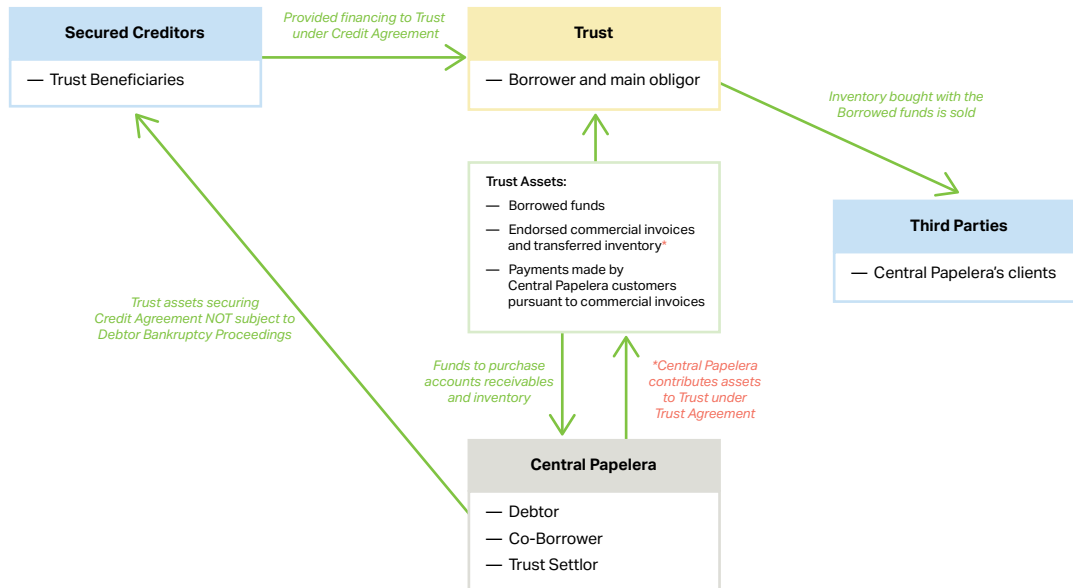
In connection with the transaction, Central Papelera signed a promissory note that imposed an obligation on the company to repay the lines of credit, thereby rendering it a co-obligor (*deudor solidario*). Furthermore, pursuant to the trust agreement, Central Papelera was required to endorse invoices and transfer inventory as contribution to the

trust; therefore, any payments made by Central Papelera’s customers were automatically credited to the trust.

Upon commencement of Central Papelera’s reorganization proceeding, based on Article 17 of Law 1116, Central Papelera requested that the Bankruptcy Court (i) order the trustee to refrain from making any future payments to

Colpatria Multibanca, (ii) declare ineffective any payments made by the trustee to Colpatria Multibanca after the commencement of Central Papelera’s reorganization proceeding, and (iii) order the trustee to transfer all of the trust’s assets and funds, both present and future, to Central Papelera’s estate.

Central Papelera Case

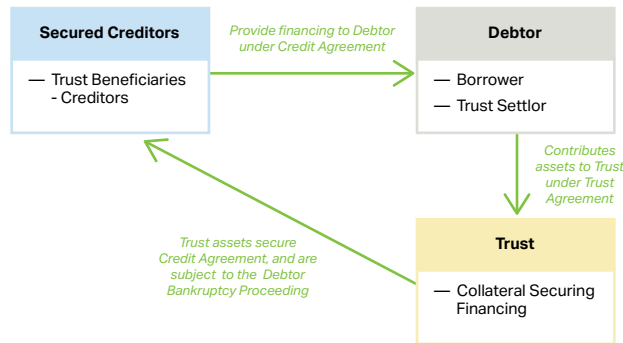


Like in the Campollo case, the Bankruptcy Court analysed the purpose of the trust agreement and held that the trust was set up to pay and secure the trust’s obligations in respect of the two credit lines with Colpatria Multibanca. In support of its decision, the Bankruptcy Court highlighted that the trust was registered in the Colombian Registry of Secured Transactions (*Registro Nacional de Garantías Mobiliarias*) as debtor and guarantor of the debt and that the trust received the funds directly from the bank. The Bankruptcy Court found, therefore, that the beneficiary and direct creditor of the trust was Colpatria Multibanca and that the commercial invoices and inventory constituted accounts receivable and were part of the trust’s estate since they were contributed by Central Papelera in connection with its obligations as trust settlor under the trust agreement. Based on its findings, the Bankruptcy Court concluded that the principle of universality and automatic stay under Law 1116 did not apply to the trust. Notably, the Bankruptcy Court held that the fact that Central Papelera was a co-debtor under the

lines of credit was not relevant to the analysis, given that Central Papelera’s obligations were pursuant to a promissory note, as opposed to the trust agreement, and arose after the execution of the trust agreement.

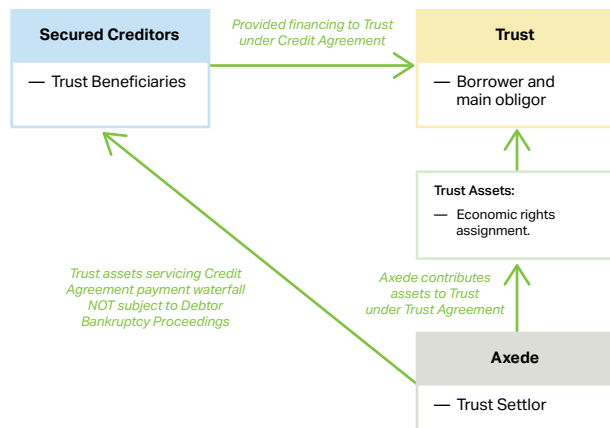
The third ruling in this line of cases was issued in connection with the Axede S.A. (“**Axede**”) reorganization proceedings.⁶ This case is particularly interesting as the Bankruptcy Court compared two trusts, one structured as a Collateral Trust and the other as an Independent Trust. Axede, which served as the settlor of each trust, requested the Bankruptcy Court to declare ineffective all payments made by the trustees to the trust beneficiaries in connection with Axede’s pre-reorganization debts.

Axede Case - Collateral Trust



In this case, the analysis of the Bankruptcy Court focused on the types of obligations that were being paid by each trust. In its decision, the Bankruptcy Court sustained the rule that trusts set up as Collateral Trusts are intended to pay the trust settlor’s debts and, therefore, fall within the scope of the automatic stay and principle of universality. Thus, the Bankruptcy Court held that the trustee of Axede’s Collateral Trust was barred from paying debts that Axede accrued prior to the commencement of its reorganization proceedings and ordered the trustee to reimburse trust proceeds that were previously used to pay Axede’s pre-reorganization claims.

Axede Case - Independent Trust



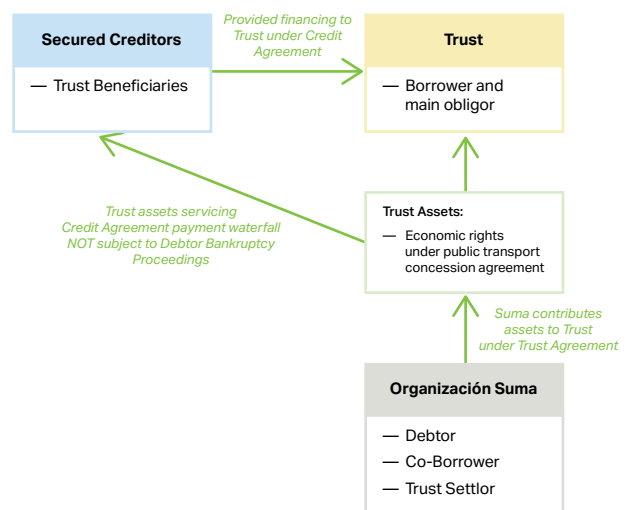
With respect to the second Axede trust, the Bankruptcy Court stated that, given that Independent Trusts act as the direct borrower and main obligor, the obligations paid by the trust are not subject to the automatic stay and principle of universality. The Bankruptcy Court also reiterated its prior holding that the assets of an Independent Trust are part of the trust’s estate, not the trust settlor’s estate; therefore, if the trust settlor contributes the economic rights of its own

contracts to the trust pursuant to the trust agreement, the income derived from the performance of such contracts is deemed part of the trust’s estate. In light of this distinction, the Bankruptcy Court held that the second of Axede’s trusts, which was structured as an Independent Trust, was not subject to the automatic stay and principle of universality.

Finally, the latest and most recent decisions in this line of cases were rendered in Organización Suma S.A.S. (“**Organización Suma**”) reorganization proceeding (the “**Suma Decisions**”).⁷ The Suma Decisions confirmed the distinction drawn by the Bankruptcy Court between Collateral Trusts and Independent Trusts. Furthermore, the Suma Decisions represent the first rulings by the Bankruptcy Court that relate to the use of trusts as security interests in the context of a project finance transaction.

In this case, a trust set up by Organización Suma (the “**Suma Trust**”) served as the main obligor under a syndicated loan agreement with two banks, while Organization Suma served as co-obligor under such agreement.⁸ Pursuant to the Suma Trust agreement, Organización Suma transferred to the Suma Trust its economic rights under a concession agreement related to the public transportation system of the city of Bogotá. In addition, the payment waterfall under the Suma Trust agreement provided that the banks’ debt was required to be serviced on a weekly basis using 50% of the funds allocated to a specific account under the Suma Trust.

Organización Suma Case





Ultimately, the Bankruptcy Court decided that the automatic stay and principle of universality did not apply to the Suma Trust. In support of its decision, the Bankruptcy Court held that the economic rights under the concession contract were part of the Suma Trust's estate and were no longer owned by Organización Suma, given that Organización Suma contributed them to the Suma Trust. The Bankruptcy Court also held that the contractual relationship between the banks and the Suma Trust, as main obligor, was independent from the relationship between the banks and Organización Suma, as co-obligor; thus, the Bankruptcy Court could not interfere with contractual agreements to which the insolvent trust settlor was not a party. Therefore, the Bankruptcy Court held that the payment waterfall under the Suma Trust could not be modified by virtue of Organización Suma's reorganization proceedings, even if such proceedings related to the provision of public services in Colombia, highlighting that any intervention by the courts could affect the financing of future projects that are essential to Colombia's infrastructure development.

Based on the Bankruptcy Court's decisions in Campollo, Central Papelera, Axede and Organización Suma, we can conclude that where a trust is structured to pay debts that arise in connection with the trust's role as direct and main obligor (*deudor principal*) under certain financing agreements, the trust assets are not automatically dragged into the trust settlor's reorganization proceeding and, therefore, the payment waterfall under the trust agreement has to be respected and

cannot be disregarded merely on account of a trust settlor's reorganization proceedings, provided that the beneficiaries of the trust are being paid in their capacity as direct creditors of the trust (as opposed to merely being creditors of the trust settlor). Underlying this new rule is the distinction drawn by the Bankruptcy Court between a trust settlor's creditors and the trust's direct creditors, and the Bankruptcy Court's emphasis on the notion that the automatic stay is only applicable to assets in possession of the debtor, thereby excluding assets that a debtor has contributed or validly transferred to a trust serving as direct and main obligor. From a practical perspective and based on the above mentioned line of cases, if a trust settlor has transferred assets to an Independent Trust, such assets are no longer considered part of a trust settlor's estate and are therefore shielded from the automatic stay provisions under Law 1116 and the principle of universality.

The case law described above provides valuable insight, from a creditor's perspective, into the Bankruptcy Court's treatment of trusts in connection with reorganization proceedings; namely, the types of trusts that can be used to achieve a degree of bankruptcy remoteness. However, it is important to note that the determination of whether a trust is bankruptcy remote is made by the Bankruptcy Court on a case-by-case basis. In addition, although they may serve as guidelines for future decisions, decisions rendered by the Bankruptcy Court do not necessarily have strict precedential value under Colombian law.

Trusts in judicial liquidation proceedings

A different set of rules applies to trusts in the context of judicial liquidation proceedings. Pursuant to Colombian insolvency law, upon the initiation of liquidation proceedings, all contracts are automatically terminated; therefore, a debtor's assets are effectively pulled into the liquidation proceeding and considered part of a debtor's liquidation estate without consideration of the nature of the trust holding such assets. In other words, it appears that the distinction drawn between Collateral Trusts versus Independent Trusts in the context of reorganization proceedings is not relevant to the determination of bankruptcy remoteness in the context of liquidation proceedings.

Notwithstanding the principles described above, with the enactment of Law 1676 of 2013, it is possible to exclude assets from a liquidation estate through the use of a collateral trust, provided that the trust is registered with the Colombian Registry of Secured Transactions (*Registro Nacional de Garantías Mobiliarias*) (or the applicable registry relevant to the type of asset) before the date of commencement of the liquidation proceeding.⁹ This prerogative¹⁰ was enforced in the Datapoint de Colombia S.A.S. (“**Datapoint**”) judicial liquidation proceeding with some limitations. In this case, the Bankruptcy Court analyzed a trust in which the underlying collateral were economic rights from a contract executed by the settlor. The main issue here was whether the future cashflows derived from the economic rights had to be excluded from the liquidation estate. The relevant consideration to the Bankruptcy Court's decision as to whether to exclude the assets held in the trust was the determination of the time in which the liquidation proceeding was commenced. Indeed, the Bankruptcy Court stated that only assets that are part of the trust at the time of admission of the settlor to liquidation may be excluded. Therefore, assets that are yet to be transferred to the trust as of the date of commencement of the liquidation proceedings, such as the future cashflows derived from economic rights, may not to be excluded from the liquidation estate, meaning that such assets should be distributed among all of the debtor's creditors, without any preference to the secured creditors of the collateral trust.¹¹

The Datapoint case is relevant to creditors because it sets forth a temporal criteria—the admission of the settlor to liquidation—to determine the extent of secured creditors' rights where their security interest is a Collateral Trust in which the underlying collateral are economic rights from a contract executed and performed by the settlor.

Conclusion

In spite of the requirements under Law 1116, based on recent decisions of the Bankruptcy Court, it appears that secured creditors in reorganization proceedings can rely on trusts to a certain extent as bankruptcy remoteness vehicles, provided that the trusts are structured such that they act as direct and main obligors under the relevant financing documentation. In the context of liquidation proceedings, creditors can rely on the temporal parameter set forth by the Bankruptcy Court to determine whether a trust's assets may be excluded from the liquidation estate (provided that such trust is registered with the Colombian Registry of Secured Transactions or the applicable registry relevant to the type of trust asset in question before the date of commencement of the liquidation proceeding).

Despite the case law described above, however, there are certain issues that remain unaddressed by the Bankruptcy Court. For instance, although the rules set forth in Campollo and re-affirmed in the Suma Decisions are applicable to reorganization proceedings, it remains unclear whether such rules regarding bankruptcy remoteness apply to Independent Trusts in the context of judicial liquidation proceedings. Therefore, it remains unclear whether creditors can enforce their collateral (*i.e.*, foreclose on the trust's assets) based on the argument that such assets are not part of the settlor's liquidation estate.

In addition, references in the Suma Decisions to the economic context of the underlying transaction leaves open the question of whether the Suma Decisions are the first of a new line of cases applicable only to project finance transactions¹² or whether, so long as the trust acts as an independent entity, the economic context is not a key factor in determining the applicable treatment of such trust in the context of a settlor's reorganization proceeding. ■

1. Articles 17 and 50 of Law 1116 of 2006.
2. Writ No. 400-004422 of the Colombian Superintendence of Companies in the reorganization proceeding of Panthers Machinery S.A.S. Decision No. 2016-01-105759 of March 22, 2016; Writ No. 400-006617 of the Colombian Superintendence of Companies in the reorganization proceeding of Productos Químicos Panamericanos S.A. Decision No. 2016-01-244309 of April 29, 2016; Writ No. 400-013085 of the Colombian Superintendence of Companies in the reorganization proceeding of Redes y Proyectos de Energía S.A. Decision No. 2018-01-432895 of October 1, 2018.
3. Writ No. 430-004714 of the Colombian Superintendence of Companies in the reorganization proceeding of Campollo S.A. Decision No. 2014-01-154706 of July 4, 2014.
4. In the context of financing transactions, the Bankruptcy Court has held that a trust acting and executing a credit agreement in the capacity of borrower is deemed to be a direct and main obligor. Whenever a trust is solely set up as a collateral trust, but does not execute the credit agreement (and has no rights to the proceeds), the Bankruptcy Court has deemed that such trust has no direct creditors and, therefore, the trust assets are dragged back into the settlor's insolvency estate.
5. Writ No. 400-014007 of the Colombian Superintendence of Companies in the reorganization proceeding of Central Papelera de Colombia S.A.S. Decision No. 2016-01-466059 of September 16, 2016; Writ No. 400-003830 of the Colombian Superintendence of Companies in the reorganization proceeding of Central Papelera de Colombia S.A.S. Decision No. 2017-01-003830 of February 2, 2017.
6. Writ No. 400-011925 of the Colombian Superintendence of Companies in the reorganization proceeding of Axede S.A. Decision No. 2017-01-011925 of August 2, 2017.
7. Writ No. 400-015798 of the Colombian Superintendence of Companies in the reorganization proceeding of Organización Suma S.A.S. Decision No. 2018-01-549145 of December 18, 2018; Writ No. 400-002370 of the Colombian Superintendence of Companies in the reorganization proceeding of Organización Suma S.A.S. Decision No. 2019-01-075629 of March 26, 2019.
8. Suma Trust and Organización Suma signed a promissory note by which they promised as main obligor and co-obligor (*avalista*), respectively, to pay the banks the syndicated loan.
9. Pursuant to Law 1676 of 2013, once the collateral is executed, it must be registered in the Moveable Assets Securities Registry (*Registro de Garantías Mobiliarias*). Registry is commonly made simultaneously or shortly after the relevant financing transaction, before the bankruptcy proceeding is commenced. Additionally, for the enforcement of the security during a bankruptcy proceeding, the secured creditor must register an additional form (*formulario de ejecución*), to be filed with the request of enforcement of the collateral (reorganization proceeding) or the exclusion of the assets (liquidation proceeding).
10. Prior to the enactment of Law 1676 of 2013, pursuant Article 55 of Law 1116 and Article 12 of Decree 1038 of 2009, it was possible to exclude the assets from the liquidation estate provided that they had been contributed to the trust with the purpose of financing the debtor. However, under the current regulation, the contribution for financing purposes requirement was eliminated and the condition to exclude assets from the liquidation estate is the existence of a security agreement duly registered before the relevant registry.
11. Writ No. 400-017527 of 28 December 2015 of the Colombian Superintendence of Companies in the liquidation proceedings of Datapoint de Colombia S.A.S. Decision No. 2015-01-526680 of December 30, 2015; Writ No. 400-005775 of 15 April 2016 of the Superintendence of Companies in the liquidation proceeding of Datapoint de Colombia S.A.S. Decision No. 2016-01-190200 of April 18, 2016.
12. In the Suma Decision, as noted above, the Bankruptcy Court highlighted the importance of taking into consideration the overall objective of reorganization proceedings in Colombia (that is, to maintain the debtor's corporate purpose) and noted that collateral structures agreed upon with creditors in the context of infrastructure project finance transactions must not be disregarded, among others, due to the importance of these types of investments to the development of the country's infrastructure.



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