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# Colombian Bankruptcy Law Amidst The Covid-19 Pandemic

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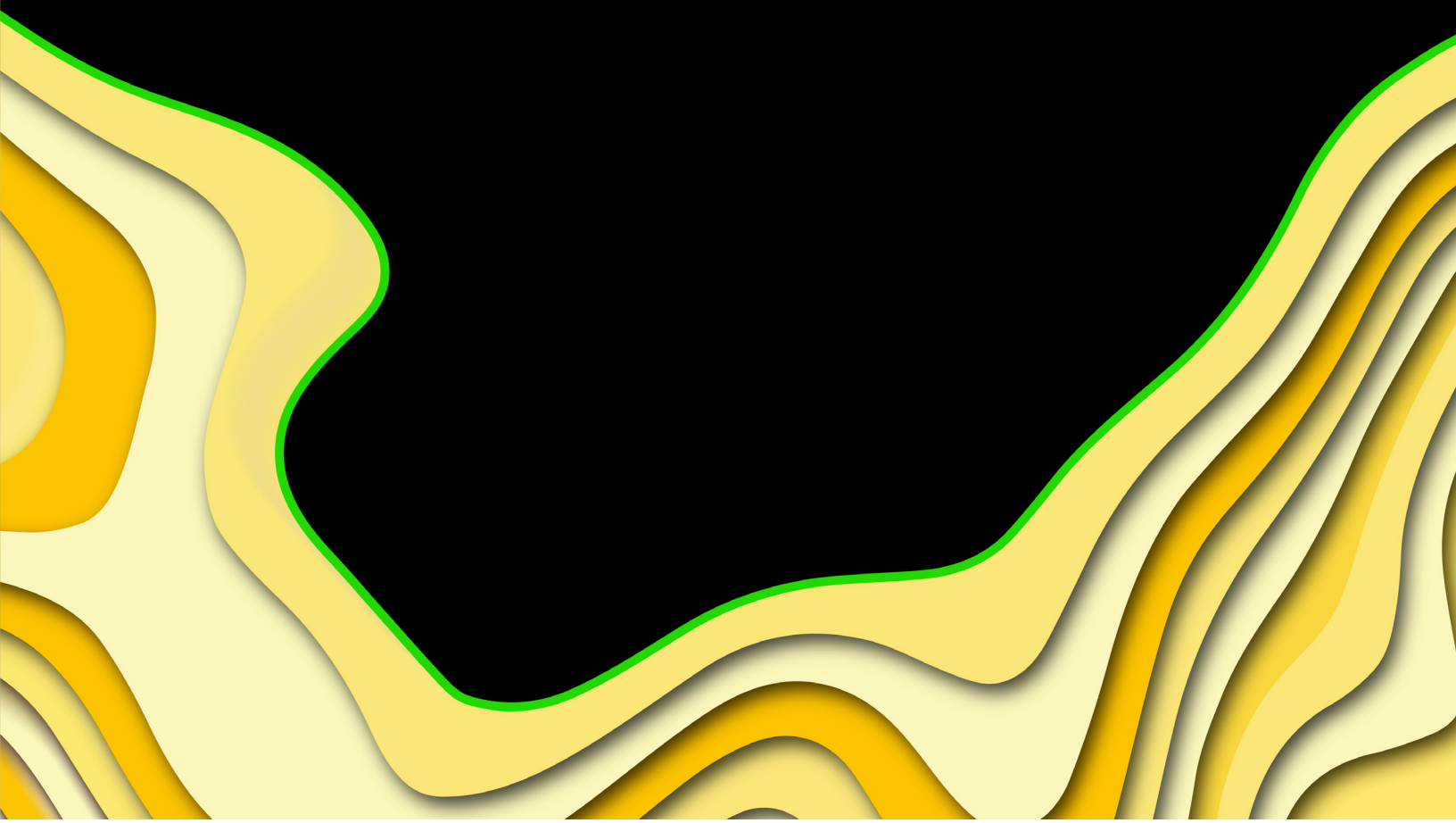
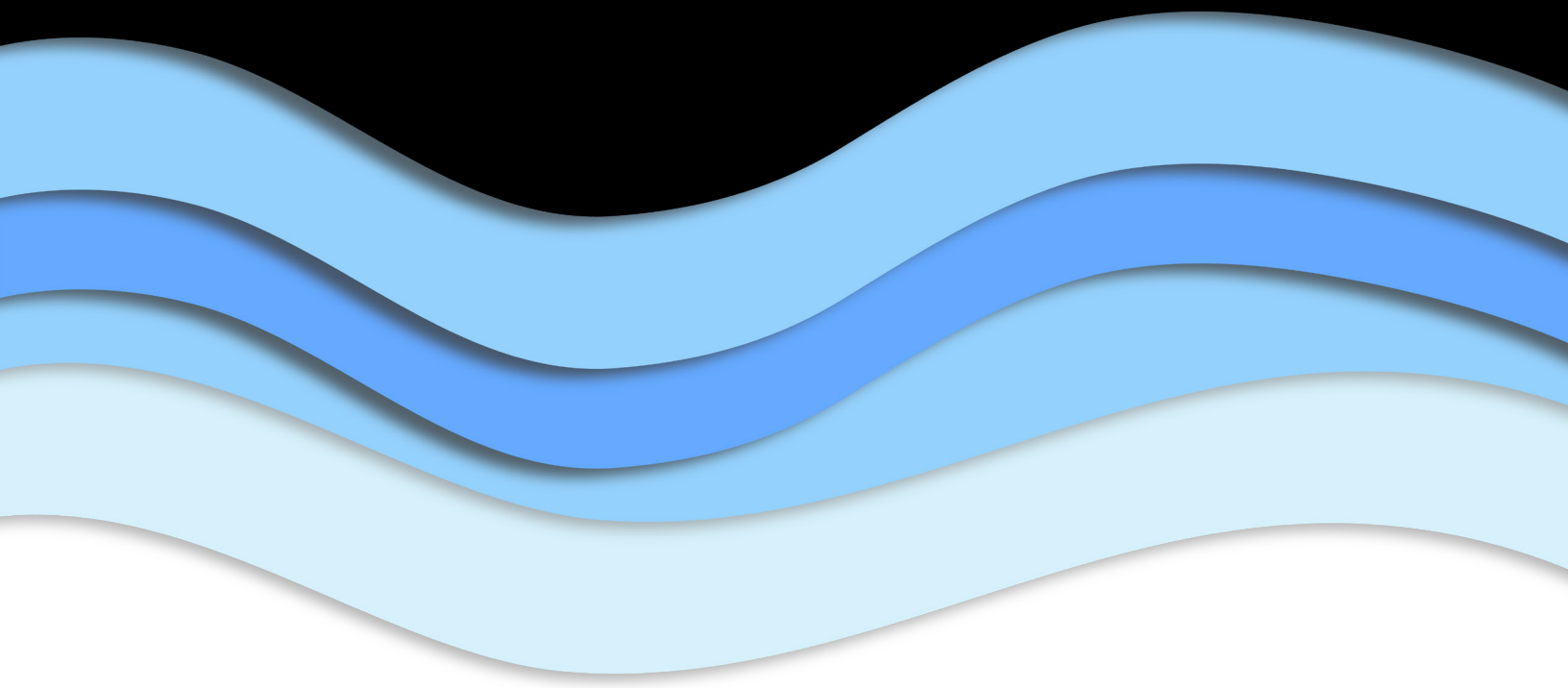


# In This Issue



2020 has been a disruptive year for some business throughout the world. The Covid-19 pandemic made it crucial for policy makers to respond with an adequate legal and institutional framework able to tackle the financial struggles of the companies affected by the crisis. Colombia has been no exception. As a result, the Colombian Government has enacted new emergency regulation concerning the bankruptcy regime established in Decree 560, Decree 772, Decree 842, and Decree 1332 of 2020 ("Decree 560", "Decree 772", and "Decree 842", jointly, the "Decrees").

With the Decrees, the Colombian Government aims at having a better-suited bankruptcy regime vis-à-vis the challenges posed by the pandemic. In general, the emergency regulation (i) provisionally amended Law 1116 of 2006 ("Law 1116"), which encompasses the Colombian general bankruptcy regime; (ii) created tailor made, expedite and abbreviated proceedings; and (iii) provided rescue measures for businesses in distress.

# Provisional Amendments to Law 1116

Although Colombia has several special bankruptcy regimes, Law 1116 is the most relevant and broadly applied, which regulates the reorganization and judicial liquidation proceedings for commercial and mixed companies, merchants, trusts that perform business activities, and foreign companies' branches. Accordingly, through the Decrees, Colombian policy makers decided to adapt this regime to address the challenges that the Covid-19 pandemic has created.

Among the emergency regulation objectives is to achieve more expedited proceedings. Indeed, companies affected by the Covid-19 crisis need swift access to bankruptcy relief -such as an automatic stay of its pre-petition obligations and to rapidly achieve a binding agreement with its creditors- to restructure their business. Thus, Decree 560 simplified the admission to the traditional insolvency proceedings set forth in Law 1116 for companies that have been affected by the pandemic and ordered that filings of those firms must be preferentially reviewed by the Bankruptcy Court. According to Decree 560, the Bankruptcy Court will only review that all the required documents to initiate the proceeding have been submitted but will not audit them. Additionally, Decree 560 and Decree 842 allowed debtors in reorganization proceedings to pay small obligations (i.e. obligations that do not exceed 5% of the total liabilities) and sell non-essential assets to pay them without Bankruptcy Court's prior authorization as was required by Law 1116.

Moreover, pursuant to Law 1116, a debtor can file for bankruptcy when the existence of adverse circumstances in the respective market or in its business structure materially affect or may reasonably affect the payment of its short-term liabilities (one year or less). Decree 560 suspended the imminent payment default the circumstances for a twenty-four-month term, in order to avoid an exponential surge in bankruptcy applications that might cause the court system to collapse because of the crisis. These amendments will initially remain in force for two years.

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# Newly Created Bankruptcy Proceedings

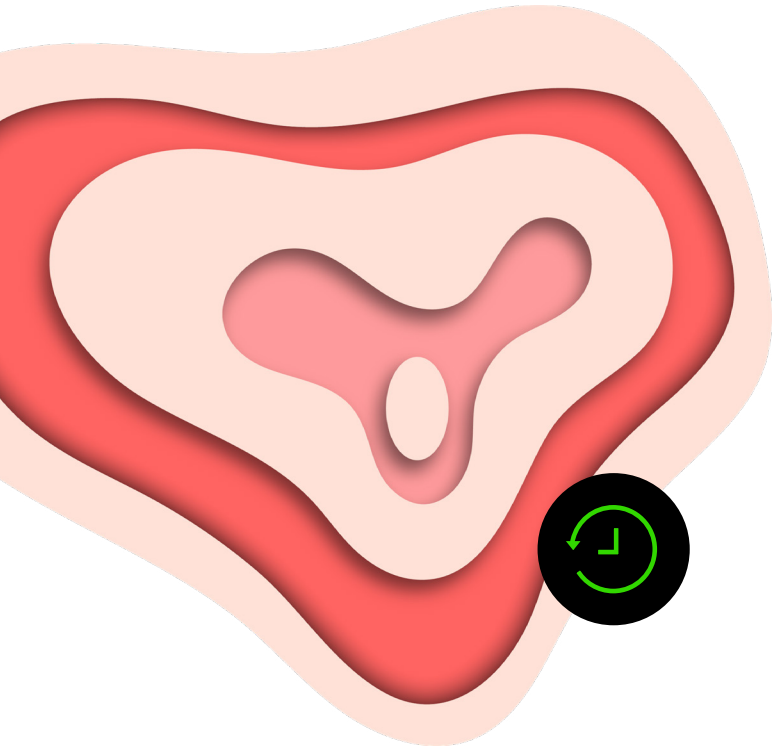
Law 1116 regulates the traditional reorganization and judicial liquidation proceedings. These proceedings have several procedural stages and according to a Superintendence of Companies'[1] April 2020 study, from the moment the debtor is admitted to a traditional bankruptcy proceeding until the moment the last hearing is summoned, they have an approximate duration of 20 months[2]. In any event, this time frame will vary depending on the complexity of the case and the availability of the Bankruptcy Court, amongst other factors.

However, the long duration of the traditional bankruptcy proceedings will not effectively contribute to tackling the financial problems of firms affected by the Covid-19 crisis and, accordingly, the policy makers created four new bankruptcy proceedings. First, Decree 560 created two new expedited proceedings: (i) the **emergency negotiation of a reorganization agreement proceeding** and; (ii) the **business recovery proceeding** before a chamber of commerce. Also, Decree 772 created two additional abbreviated bankruptcy proceedings: (iii) the **abbreviated reorganization proceeding** for small bankruptcies and (iv) the **simplified liquidation proceeding** for small bankruptcies.

In general, the effects of the admission to one of the newly created bankruptcy proceedings remain the same as a traditional bankruptcy proceeding. Thus, when the debtor is admitted to a bankruptcy proceeding, the debtor will be stayed from (i) amending its by-laws, (ii) granting or enforcing security interests over debtor's assets, including collateral trusts; (iii) paying or otherwise compensating any outstanding pre-petition obligations; (iv) entering into arrangements or settlements regarding any outstanding obligations; (v) terminating judicial proceedings; and (vi) transferring assets and carrying out operations out of its ordinary course of business. Also, collection proceedings against the debtor will be suspended (automatic stay).

## The Emergency Negotiation of a Reorganization Agreement

The emergency negotiation of a reorganization agreement proceeding is intended to be a simplified and expedited version of the traditional Law 1116 reorganization proceeding. This proceeding allows the debtor to directly negotiate with all or certain categories of creditors for a three-month period in order to execute a reorganization agreement. Unlike the reorganization



proceeding, the emergency negotiation provides the debtor with the possibility to personally conduct the proceeding in a period that cannot be suspended or extended. The proceeding will only have one hearing before the Bankruptcy Court in which the Court will hear the objections against the claims order and will rule on the confirmation of the reorganization agreement.

If the agreement is confirmed, it is binding on all the creditors, even for the ones that voted against the reorganization agreement. If the reorganization agreement is not approved, the Superintendence will declare the failure of the emergency reorganization proceeding and the debtor will be banned from requesting admission to the emergency mechanisms provided for in Decree 560 during the next year, nevertheless, it may initiate a traditional reorganization proceeding under Law 1116. This consequence differs drastically from a traditional reorganization proceeding in which the effect of the failure to confirm the reorganization is the immediate commencement of a liquidation proceeding.

Additionally, according to Decrees 560 and 772, during the reorganization agreement negotiation period the debtor can suspend the payment of administrative expenses to unrelated creditors if it reasonably justifies the suspension and acts in good faith. The debtor will have to pay those expenses in the month after the agreement is approved or if the negotiation is deemed failed. Expenses related to obligations towards the debtor's employees cannot be suspended.

## The Business Recovery Proceeding

On the other hand, the business recovery proceeding before a chamber of commerce also allows the debtor to negotiate with its creditors for a three-month period with the assistance of a mediator. The proceeding will take place before a chamber of commerce and the confirmation of the agreement will be subject to the Bankruptcy Court through an additional proceeding. Unlike the proceedings set in Law 1116 or emergency negotiation of a reorganization agreement proceeding, the business recovery proceeding has a cost that will vary depending on the total amount of the debt[3].

This proceeding, like the emergency negotiation proceeding, allows the debtor to negotiate with all or certain categories of creditors in order to execute a reorganization agreement. If the agreement is approved and duly voted by the majority of the creditors, then the agreement is only binding for the creditors that voted in favor of the reorganization agreement, unlike under Law 1116. If the debtor intends to make the agreement binding on all the creditors, it will have to request that the Superintendence of Companies judicially validate an out-of-court reorganization agreement. In the event the agreement is not approved, the chamber of commerce will declare the failure of the proceeding and the debtor will be banned from requesting admission to the emergency mechanisms provided for in Decree 560 during the next year, nevertheless, it may initiate a traditional reorganization proceeding under Law 1116.

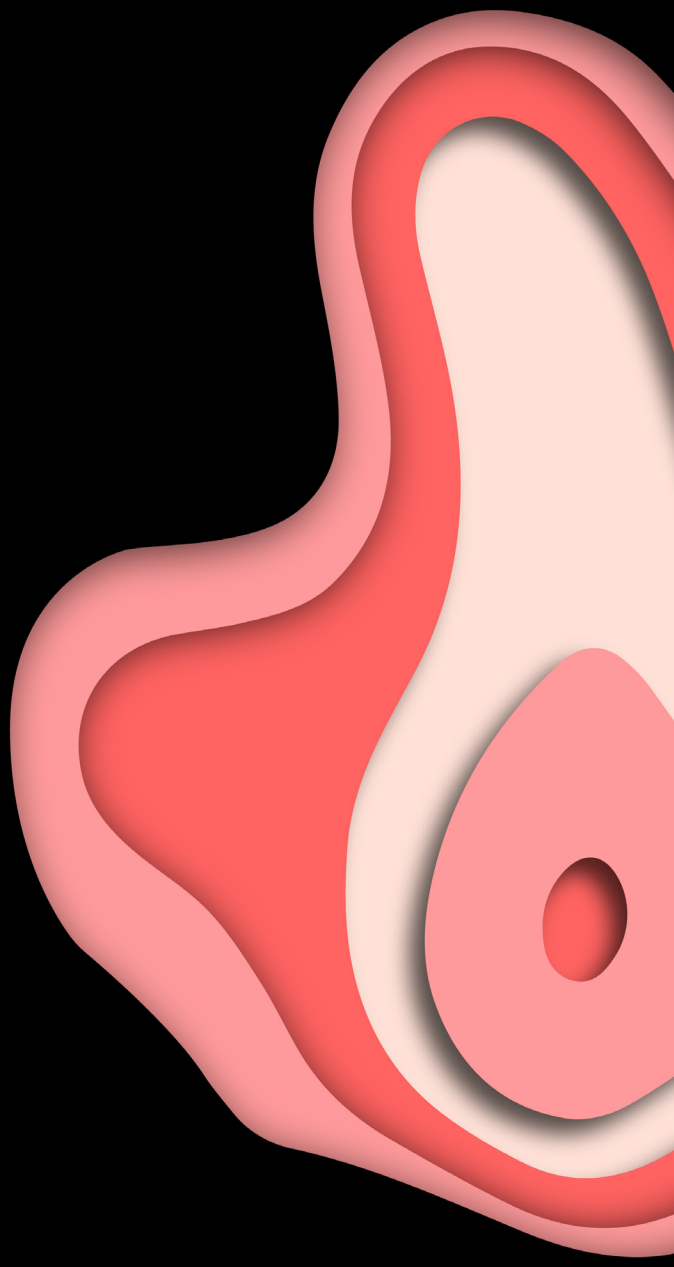
Interestingly, this proceeding provides that objections and observations by the creditors may be solved through any of the alternative dispute resolution methods contemplated by Colombian law, such as arbitration and extrajudicial settlements, among others.

## The Abbreviated Reorganization Proceeding for Small Companies

Pursuant to Decree 772, debtors whose assets are less than 5,000 Colombian legal minimum monthly wages (approximately USD$1.2 million) can access an abbreviated reorganization proceeding. In this proceeding, the Bankruptcy Court promotes the settlement of objections and then concentrates the stages of a traditional reorganization in just two hearings during which (i) the debtor and its creditors seek to reach settlements of the obligations before the Bankruptcy Court and; (ii) the Bankruptcy Court rules on the pending objections raised by the creditors and on the confirmation of the reorganization agreement.

## The Simplified Liquidation Proceeding for Small Companies

Debtors whose assets are less than 5,000 Colombian legal minimum monthly wages (approximately USD$1.2 million) can also request the admission to a simplified liquidation proceeding. Unlike Law 1116, this proceeding has fewer stages and shorter deadlines to accelerate and simplify the proceeding. In this proceeding, the Bankruptcy Court seeks the settlement of creditors' objections before moving on with the rest of the procedural stages. It does not contemplate a formal valuation of the estate and instead it considers its net value. Creditors can challenge this value through binding offers or filing valuations. No votes are assigned to creditors and assets are directly assigned to the creditors by the Bankruptcy Court instead.



# Rescue Measures

In addition to provisionally amending the general bankruptcy regime and creating new proceedings, the Decrees also establish rescue measures that seek to create incentives to facilitate the business recovery:

**(i) Capitalization of credits:** creditors can capitalize their credits by receiving shares of the debtors or senior bonds.

**(ii) Discharge of debts:** the debtor company can discharge the part of its debt that exceeds its valuation as an economic unit. When this happens, Decree 560 provides that the debtor's shareholders will lose their shares in the company since the external debt exceeds the valuation of the firm as economic unit capable of generating cashflows. The discharge of debts is subject to approval from creditors of at least 60% of the external debt.

**(iii) Sustainable debt agreements:** financial debt can be restructured through a bond issuance which allow financial creditors who agree to receive a portion of the credit with those bonds which are not subject to the reorganization agreement.

Decree 560 also creates incentives for creditors who provide liquidity with the purpose of making the debtor's business viable through guarantees and priority of payments. Additionally, the emergency regulation provides bailout mechanisms to prevent the liquidation of the debtor. Also, Decree 560 relaxes the requirements and limitations and further facilitates obtaining financing following the bankruptcy petition.

Specifically, in certain circumstances, Decree 560 allows the debtor to obtain financing without the Bankruptcy Court's prior approval. Perhaps more importantly, (i) this financing is granted the same level of priority as other post-petition claims and; (ii) the debtor is allowed, subject to the Bankruptcy Court's approval, to grant a lien on its assets to secure payment of any obligation resulting from a post-petition financing. To secure payment of the post-petition financing, the debtor can encumber otherwise unencumbered assets, grant a junior lien over previously encumbered assets, and grant a senior lien over previously encumbered assets. This last option requires the consent from the secured creditor or, in absence of such consent, the Bankruptcy Court's approval which will require the reasonable protection of the original secured creditor.

# Conclusion

The Covid-19 pandemic poses great challenges for bankruptcy law, specially for emerging markets where efficient judicial proceedings are not generally available. The innovations provided by Colombia's emergency regulation, however, has so far proven to have had a positive impact concerning access to expedite proceedings.

In fact, whilst reorganization proceedings had a duration of approximately 20 months under the pre-Covid regime, new proceedings, such as the emergency negotiation proceedings of Prosalon S.A. and Aluminio Nacional S.A. are takin gapproximately 5 months. Of course, the available sample of cases is not representative to reach a definitive conclusion on the effectivness of the new regulation. Nonetheless, there are good signs that the Colombian response to the pandemic concerning bankruptcy law might be achieving the goals for expedited access to bankruptcy relief and an adequate legal framework for business recovery. Furthermore, some of these contingency measures may become permanently part of the Colombian bankruptcy regime.

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Recognized as a Leading Lawyer in Corporate M&A and Projects in Legal 500-2016.

1. The Superintendence of Companies is the Colombian specialized Bankruptcy Court.
2. Colombian Superintendence of Companies, Facts and Figures of Colombian Bankruptcy Proceedings "Atlas de Insolvencia-Insolvencia en Colombia: Datos y cifras 14 de abril de 2020" April 14, 2020. Bogotá D.C.
3. Centro de Arbitraje y Conciliación de la Cámara de Comercio de Bogotá, Fees for the bussiness recovery proceeding: https://www.centroarbitrajeconciliacion.com/Servicios/Mediacion-empresarial/Tarifas


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