The Nuts and Bolts of Uruguayan Insolvency and Bankruptcy Laws

By **HECTOR FERREIRA**

Uruguay has a substantial tradition of bankruptcy laws which have allowed many foreign creditors to recover the value of their investments and recognized international insolvency proceedings.

The Uruguayan insolvency regime is regulated by Act No. 18.387 (*Ley de Proceso Concursal or the "Act"*) enacted in 2008 and as further amended by Act Nos. 18.593 and 18.937.

Under this law, business reorganization and debtors' rights, which have been the pillars of the traditional Uruguayan insolvency regime, were balanced with newer international trends seeking more efficient proceedings and creditor protections.

An overview of the act and the Uruguayan insolvency system

The Uruguayan insolvency system has the following main objectives:

1. Reduce the risks of significant losses caused by liquidation proceedings;
2. Encourage negotiations and agreements between the parties;
3. Increase the opportunities for the debtor to continue as a going concern;
4. Limit the number of financially-strapped companies in the market; and
5. Seek the best solution for creditors.

However, the insolvency proceedings under the Act do not apply to:

1. Other individual debtors (*i.e.*, non-investment professionals), whose reorganization and bankruptcy proceedings are governed by similar rules laid down at the civil procedure code;
2. State, local governments and public sector companies; and
3. Financial Institutions *(e.g.*, banks, private equity funds, hedge funds, insurance firms and venture capital firms), which are subject to regulations promulgated by the Central Bank of Uruguay (*Banco Central de Uruguay*).

Under the Uruguayan system, there is no distinction between insolvency proceedings involving corporations and investment professionals. A single set of rules regulates the insolvency proceedings of any investment professional or corporation doing business in Uruguay. Uruguayan lawmakers have also expanded the scope of the Act to address other special reorganization or bankruptcy situations such as a deceased debtor’s estate reorganization and claims from his or her heirs.

The Reorganization Proceeding: the “*Concurso*”

There is only one reorganization proceeding called “*concurso*” which can generally be initiated when the debtor is in default. In Uruguay, the parent company of a conglomerate can file for a reorganization proceeding or bankruptcy for the whole group. By the same token, any creditor of any of the companies can file for a reorganization proceeding or bankruptcy of the entire corporate group.

When a corporation falls behind in its debt payments, the Uruguayan insolvency regime encourages parties to act quickly. Under the Act, the debtor has the obligation to request a reorganization proceeding within 30 days after the debtor had known or should have known of its insolvency status. Once the debtor files for a reorganization proceeding, seeking to save its business and protect its creditors, the debtor is still permitted to receive interim financing to continue its operations during the proceeding. In addition, the debtor’s actions, except for those related to gross negligence, fraud and the like, that contributed to its financial woes will not be criminally prosecuted, provided creditors are compensated in accordance with the Act.

Creditors cannot abandon an in-court reorganization proceeding once initiated. In addition, creditors are held liable for damages to the debtor if the petition was unreasonable or abusive. The Bankruptcy Court (*Juzgado Letrado de Primera Instancia de Concursos*) may ask creditors to post a judicial bond (except in the case of creditors who are also employees of the debtor) to indemnify the debtor from any loss arising out of the legal proceeding.

Stages of the Concurso

The Act divides the insolvency proceeding in the three stages below. However, the debtor may enter at any point into private, out-of-court agreements with creditors to avoid liquidating the company’s assets, and these agreement are only binding on the parties that have signed them.

1. **Negotiation with creditors:** The debtor and creditors negotiate and enter into an agreement to restructure the business with a plan that may feature any of the following: (a) partial discharge of creditor claims; (b) extension of the debtor's maturity terms; (c) assignment of assets to creditors; (d) formation of a company made up of creditors without any preferred claims; (e) debt capitalization; (f) formation of a trust; (g) company reorganization; or (h) partial or complete asset management in benefit of the creditors.

   Even if the business is insolvent, the company continues to operate during the first stage of the reorganization proceeding and is either managed by the debtor (with a co-manager appointed by Court) or by a receiver. This first stage may last at least 60 business days from the first creditors' meeting.

2. **Selling the business as a going concern:** If negotiations with creditors are unsuccessful, Section 171 of the Act states that every effort would be made to seek the sale of a business as a going concern. The Act encourages the survival of the business by selling it as a going concern instead of selling it off in different pieces. For example, the Act now allows for an auction process that fairly balances the objectives of ensuring a reasonable continuation of the business, securing strong workers' protection and satisfying creditor claims.

   If the business continues, employment agreements are not terminated and any lawsuits brought by employees are typically dismissed. In addition, worker cooperatives or other employee organization running a company that is in default may participate as credit bidders (as opposed to cash bidders) in the auction process. In that event, the employees would apply the capital of the acquired company to their credits against the debtor.

3. **Selling the business into different pieces:** The liquidation of the company's individual assets may be completed in the event that no agreement is reached to sell the company as a whole. The Act requires the receiver to present a liquidation plan to the creditors' commission, which is formed by the members of the creditors' meeting, within 30 days from the Bankruptcy Court's resolution ending the sale of the business as a whole. Note that even if the business is divided into individual assets, the Act encourages sales of the business in "productive units" *(venta en bloque de la empresa en funcionamiento).*

The Receivership

If the Bankruptcy Court declares a debtor insolvent, which depends on various factors such as the debtor's short-term and long-term debt, financings and overall liquidity, one of the first measures to be taken is the appointment of a receiver to manage the debtor's assets and creditors' claims (either alone or in cooperation with the debtor). The company's directors and management team may or may not be removed once a received is appointed.

A registry of receivers was created under the supervision of the Bankruptcy Court. A limited number of receivers have been included in the registry and will remain in their positions for a period of four years.

Receivers must have some previous experience in the company's business and at least five years of professional practice or be a professional organization (in which case, their members must comply with aforementioned qualifications). They must report to the Bankruptcy Court when requested.

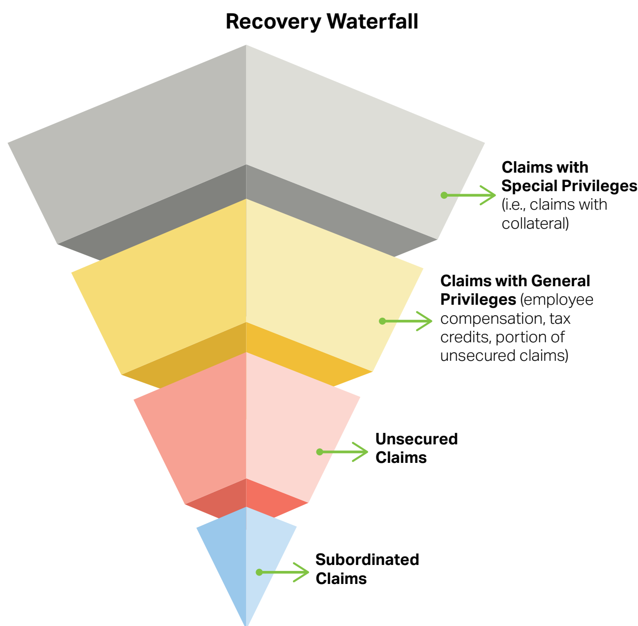
Any receiver appointed by the Bankruptcy Court may be removed from their position in the event they extend their term for more than two years since the ruling authorizing the winding down of the business. In this case, the receiver will cease to receive a salary, and the amounts received since their appointment would be disgorged.

The Ranking and Payment of Claims In the Proceeding

The Act modified the preferential treatment of claims from the former insolvency system. The preferential ranking of the claims are: claims with special privileges, claims with general privileges, unsecured claims and subordinated claims.

The receiver must set aside the corresponding funds to pay legal fees and claims that are conditioned on a monetary judgment against the debtor or could trigger an additional penalty or claim.

The Act authorizes the Bankruptcy Court to pay in advance, at any point of the proceeding, employee compensation that is not barred by the statute of limitations, which is generally one year following the termination of employment.



Claims with Privileges

There are two types of claims with privileges (special and general). Claims with special privileges are the ones collateralized by a pledge of personal property or mortgage of real property. The Act provides that the creditors will not be able to foreclose on the collateral for a period of 120 days in order to rule out the possibility of selling the business as a going concern.

Claims with general privileges have three subcategories:

1. Employee compensation of any kind accrued up to two years prior to the ruling that initiated the reorganization proceeding and up to a maximum amount of USD 31,500 per worker. Certain tax debts that the debtor did not pay to the government retirement services are also included in this category.
2. National and local tax credits payable up to two years prior to the ruling that initiated the reorganization proceeding.
3. 50% of the unsecured claims of the creditor(s) that initiated the reorganization proceeding, with a legal cap of 10% of the debtor's total liabilities—effectively giving unsecured creditors an incentive to initiate the reorganization proceeding.

Claims with general privileges are paid with proceeds of the foreclosed assets owned by the debtor. If the claims became insufficient to pay the debts, these credits will be paid pro rata in the following order: employees´ compensation; national and local taxes and 50% of the claim of the creditor(s) that initiated the reorganization proceeding.

Subordinated Claims

Subordinated claims include fines and penalties due to the government (federal and local) and claims from creditors who have other familial or commercial ties with the debtor, such as:

1. **Natural Persons:** (a) current spouse or domestic partner or those who used to have this status within two years before the ruling that initiated the reorganization proceeding; (b) parents, natural born children, their children and siblings of the debtor or of any person mentioned in (a); (c) spouse or domestic partner of parents, issues and siblings of the debtor; and (d) people who shared dwelling with the debtor within the last two years unless they were entitled to employee compensation;
2. **Business Associations:** (a) partners with unlimited personal liability and partners, members or shareholders with limited liability that owned more than 20% of the maximum share capital authorized by the company's constitutional documents; (b) managers or directors in law or in fact and liquidators as well as the ones that held those positions within two years before the ruling that initiated the reorganization proceeding; (c) business associations that are members of a group of companies which is formed when one company is led by another, when many companies are led by only one natural person or business association or when different companies work systematically in accordance; and

3. **Assignees:** refers to assignees of claims owned by original creditors who fall within the two categories above if those claims were bought within two years before the initiation of the reorganization proceeding.

State, Governmental and other Public Entities
The state, local governments, public sector companies, public governmental and non-governmental persons and other public institutions are able to participate in the reorganization proceeding seeking recovery from the debtor. They will be considered as an unsecured creditor (other than their subordinated claims) in terms of voting rights and participation in the proceeding.

Out-Of-Court Agreements

Under Article 214 of the Act, an in-court reorganization proceeding could be avoided if an out-of-court agreement between the debtor and its creditors is reached. The structure of the agreement is flexible, and the Act allows for special preferences among the creditors in the way they will be paid. Once an agreement is reached, it is submitted to the creditors' meeting[1] for approval. At least a two-third majority of the debtor's unsecured creditors must vote in favor of the agreement in order to approve it. If approved, the debtor may have it finalized by either having the agreement notarized or approved by the Bankruptcy Court.

Those unsecured and subordinated creditors who do not consent to the agreement are, as a matter of law, bound by the agreement. However, they can challenge the agreement under any of the following four grounds: (i) the agreement is in violation of the law; (ii) the signatories of the agreement do not correspond to the real holders of the credit or have been obtained in such a way that goes against the equal treatment among the unsecured creditors; (iii) compliance with the agreement is unfeasible and (iv) there is fraudulent concealment or exaggeration of an asset or liability. The challenge must be submitted through a written notice to the debtor within a period of 20 days. The debtor has 10 days to present a response to the challenge before a bankruptcy judge. If the debtor fails to respond, any creditor may request the declaration of bankruptcy before the Bankruptcy Court, in which case the Bankruptcy Court has the obligation to approve such request.

Following the approval of an out-of-court agreement, the debtor will not be held in default, there is an automatic stay imposed for one year, any foreclosures on the debtor's assets are suspended or not allowed for a period of 120 days and, in certain cases where the debtor's assets are in jeopardy, the debtor would need to receive the Bankruptcy Court's authorization to run the business.

If the debtor breaches an out-of-court agreement, for which there is no cure period provided, a new reorganization proceeding may be initiated any creditor, and the debtor will be deprived from the right of seeking other out-of-court agreements with its creditors.

Cross-Border Insolvency Proceedings

Uruguayan courts have jurisdiction over foreign debtors (natural persons, corporations and other legal entities) who have their home office (or "nerve center") abroad if this debtor had run its business in Uruguay (both maintain a physical office in Uruguay and generated sales or income in Uruguay).

General Principles
All assets and rights owned by debtor will be considered in the reorganization proceeding regardless of whether such assets or rights are located in Uruguay or abroad.

However, if the debtor asks for a reorganization proceeding or bankruptcy in a country different from Uruguay only the remaining assets and rights, after termination of the international proceeding, will be part of the Uruguayan proceeding.

Uruguayan law will be applicable to all restructuring and bankruptcy proceedings declared in Uruguay. The only exceptions are in the context of executed contracts with a choice of law provision, which will be construed based on the law chosen by parties in the contract.

Pursuant to Uruguayan law, there will be no discrimination on the ground of nationality, *i.e.*, all creditors of the debtor, regardless their nationality, will be treated in the same way by Uruguayan law. As an exception, employees have a preference claim over the proceeds from the realization of assets located in Uruguay.

However, if Uruguayan citizens are given unequal treatment in reorganization proceeding of a foreign country, Uruguay will apply the same treatment of that foreign country towards their citizens.

Other Features of the Modern Insolvency System

Totally or Partially Unexecuted Contracts

The Uruguayan system under the Act now offers several alternatives when the company has totally or partially unexecuted contracts at the date of the declaration of insolvency. One possibility is that receiver or the debtor may unilaterally terminate contracts pending of execution authorized by a court-appointed auditor. However, this alternative is not possible for any contacts that involve assignment of credits or rights, whether present or future, including real property rights and guarantee trust.

Small Proceedings

Before the Act, there was no expedient manner by which to address claims against a debtor that involve a relatively small amount. As a result of the Act, small proceedings in which debts are less than approximately USD 360,000 can be processed. Proceedings of this type are typically easier and shorter depending on circumstances of each case.

Abandoned Businesses

In addition, if the debtor fails to participate in the reorganization proceeding and the company's creditors are comprised of only its employees, the company may be assigned to such employees on a temporary basis. Once the proceeding has initiated, publications will be issued giving notice of the proceeding to creditors, and the debtor will receive be notified. If it is found that there are only claims with employees or other creditors do not challenge their claims, the company will be definitively assigned to the employees.

Criminal Liability in Insolvency Proceedings

The Act also provides that an insolvency proceeding may be treated as intentional or unintentional. It would be intentional when intentional wrongdoing or gross negligence were performed by the debtor (managers or directors in law or in fact/liquidators in case of companies) is proven. It would be also intentional when the debtor breaches the agreement with his creditors, provided that intentional wrongdoing or gross negligence performed by debtor is proven. The remaining cases would be considered unintentional.

If the proceeding is categorized as intentional, the debtor (managers or directors in law or in fact/liquidators in case of companies) and their accomplices will be disqualified as an investment professional, as well as held liable for damages, payment of fines and illegally obtained assets and rights.

The white collar crime called "insolvency fraud" is triggered when the debtor conceals or lies when declaring his liabilities and assets, grants illegal preferential treatment among creditors, or benefits in consideration of votes and conceals the corporate books.

If any receivers, court officers, expert witnesses and the like received knowledge to such illegal activity and about facts that can lead to a criminally punishable conduct, they must report any suspicions to the Bankruptcy Court.

Conclusion

The main objective of the Act under the modern insolvency system is to reduce the number of insolvent companies in favor of preserving the value of businesses through corporate restructurings. In our experience, the insolvency proceedings now possible under the Act have improved the local business environment in Uruguay. However, although Uruguayan proceedings offer both creditors and debtors some benefits, they remain relatively untested for international creditors and further practical experience is needed before it can be determined whether they provide truly meaningful opportunities for recovery. ■

1. Pursuant to Article 115 under the Act, there is no requirement on the number of creditors present or a minimum threshold of the percentage claims they represent against the debtor and no matter whether or not the debtor is present—a creditor's meeting is considered valid without any of these features. The time, date and place of the first creditors' meeting is decided by the judge at the proceeding in which the insolvency is declared.

▼ **Hector Ferreira** is a partner at Hughes & Hughes in Montevideo, Uruguay. His practice focuses on corporate M&A, banking and finance, corporate reorganization and project finance within Latin America. He received his LLM from the University of California, Davis, his JD from the Catholic University of Uruguay and a degree in International and Comparative Law from the Academy of American and International Law in Dallas, Texas.