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Trends and Developments

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Morgan & Morgan is a full-service Panamanian law firm, regularly assisting local and multinational corporations from different industries, as well as recognised financial institutions, government agencies, and individual clients. The firm has a solid legal department with ample experience advising on matters related to mergers and acquisitions, joint ventures, project finance (real estate, energy, mining, public infrastructure), syndicated lending, guaranteed loan facilities, due diligence related to credit facilities contracts, insolvency and reorganisation processes, guidance and advice in judicial processes for the collection of unpaid high-risk credits, and advice on general corporate and regulatory matters. On insolvency matters, the firm is a pioneer and has acted on behalf of creditors (mainly banks) and debtors. The firm has provided legal advice on a considerable number of processes, participating in the negotiations with both insolvent companies and their creditors, as well as legal representatives and Bankruptcy Administrators appointed by the Panamanian Court.

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The Restructuring Market in the Republic of Panama

Panama's legal insolvency restructuring market came into effect with Law 12 of 19 May 2016 ("Law 12 of 2016"), which "establishes the regime of insolvency processes and dictates other dispositions", introducing new proceedings into our legal system. These proceedings are referred to as Reorganisation and Liquidation.

The enactment of the Insolvency Law sought not only the protection of the rights of creditors, but also to achieve a differentiation between "efficient" and "non-efficient" companies, depending on the reasons and circumstances that give rise to their insolvency status.

Under the previous bankruptcy regime, liquidation proceedings are not common because of their complexity and delay in time (ten years or more). The prior system's inadequacy, and lack of a reorganisation alternative, were arguably part of the reasons for the approval of a new insolvency regime in Panama by means of Law 12 of 2016.

Law 12 of 2016 thus offers merchants the opportunity to undergo a reorganisation process in the case of imminent insolvency, lack of foreseeable liquidity, or default of an obligation that is documented as a *título ejecutivo* (an "executory title"). The Judicial Code of Panama lists *títulos ejecutivos* as obligations documented with certain formalities, in a certain form, that allow a creditor to request payment in an executory proceeding (*proceso ejecutivo*), which is a more an expedited proceeding than an ordinary judicial proceeding. Furthermore, Law 12 of 2016 provides for cross-border insolvencies in Panama.

The introduction of reorganisation processes into our legislation is positive, and perhaps, even, overdue. For 100 years, Panama has been limited to liquidation processes that have not resulted in a mechanism by which creditors may recuperate their money, or at least a significant part of it, in due time. Positively, the new Law intends to create specialised courts and judges for insolvency processes. The distinction between creditors related to the debtor, and those not related to the debtor, is another positive feature of the new law as, under the current system, the related creditors benefit from the process as if they had no relation to the insolvent debtor. We can also hope that the short negotiation periods now given to the creditors and debtors to reach an agreement on a reorganisation plan does indeed result in accelerating the process's results.

For "efficient companies", the law introduces the "Reorganisation Proceeding", the main purpose of which is the recovery and continuation of the company as an economic unit and employer.

A Reorganisation Proceeding pursues similar objectives as the bankruptcy protection provisions established in Chapter 11 of the United States Bankruptcy Code. Thus, a Reorganisation Proceeding allows the restructuring of a company's debt obligations and can be initiated at the request of the insolvent company, or by its duly organised creditors through a "Board of Creditors". The insolvency petition must be accompanied by a series of documents that include, among others, the company's financial statements, an inventory of its assets and liabilities, payroll obligations and the Reorganisation Plan, in which the debtor must provide a financial, organisational, operational and competitive restructuring project with the intention of solving the causes that led to the company's failure or inability to make required payments, its imminent insolvency or foreseeable lack of liquidity.

This Reorganisation Plan is significant in that it serves to initiate the proceeding itself. Subsequently, when the creditors formally join the proceeding to submit evidence of their credits, the Reorganisation Plan must be subjected to a vote by the established Board of Creditors, who must either approved or reject said plan. The result of this vote will decide whether a company will in effect be reorganised through the execution of said plan, whether the proceeding will culminate without any agreement, in which case the bankruptcy protections would be lifted and the debtor would have to negotiate with each of its creditors separately, or the judicial liquidation of a company.

The Judicial Liquidation Proceeding, as the name implies, focuses on liquidating "inefficient" companies in a prompt and orderly manner. This can be initiated at the request of the debtor by means of a voluntary liquidation, or by means of a duly substantiated petition from a creditor, which in this case would be a compulsory liquidation.

In either case, the petition must be accompanied by a series of requirements and documentation. In the case of a voluntary liquidation petition, provided all requirements are met, the court will issue a resolution declaring that the company is in liquidation.

For compulsory liquidation, provided all requirements are met, the request will be accepted and the debtor will be given an opportunity to answer the creditor's petition. The court will then set a date for an initial hearing. If the debtor opposes the petitioner's claim against it and the judge deems such opposition to have sufficient grounds, it shall deny the claim and the proceeding shall terminate. However, if the court deems said opposition to have insufficient grounds or if the debtor does not even submit any opposition, the debtor may:

- allocate sufficient funds for the payment of the debt;
- agree with the requesting creditor for the hearing to be suspended in order for the parties to reach an arrangement; or
- submit to a Reorganisation Proceeding.

If, however, the debtor does not choose any of the aforementioned options, the judge will issue a resolution for a Liquidation Declaration, with the corresponding legal effects.

It has been interesting to see the development and execution of this relatively new law before the courts of Panama, especially since it also provides for the creation of new Insolvency Circuit Courts, as well as the Fourth Superior Court of the First Judicial District, consisting of three justices elected by the Supreme Court with exclusive jurisdiction over insolvency proceedings. However, to date, these courts have not been created and, therefore, the Civil Circuit Courts are currently in charge of hearing these proceedings.

These circumstances have forced the judge's ruling over these cases to become overly reliant on the technical criteria of the Bankruptcy Administrators appointed by them within the proceeding.

Consequently, said Bankruptcy Administrators, who serve as an assistant of the Court, must have the legal and accounting capacity to warn of possible irregularities within the proceeding, from the initial scrutiny of the insolvency application, together with all the supporting documentation. They must also be able to determine if they are facing an efficient company that can improve its current financial condition, and they must even make recommendations against the aforementioned Reorganisation Plan before it is submitted to the Board of Creditors for their vote. This level of expertise, although not expressly required by law, has become a necessity given the unforeseen preponderance that the expert input of these Bankruptcy Administrators has acquired.

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Another concern is that debtors may intend to abuse the financial protection provided by the reorganisation process during the Period of Financial Protection. Furthermore, the allowance for foreign insolvency process representatives to file a reorganisation request intends to accommodate to a globalised world (which is positive in our opinion), but, in practice, may be a challenge for local courts in regards to acknowledging foreign judicial resolutions concerning the foreign processes.

It is recommended, for all merchants with business interests in Panama, to familiarise themselves with the Insolvency Processes Reorganisation and Liquidation Law. Already, the drafting of any real guarantee contracts (such as mortgages) or guarantee trusts and, in general, any other commercial contracts under Panamanian law, must take into account the Law's provisions in anticipation of it coming into effect and the subsequent transitions of any existing contract obligations into the new insolvency system. Merchants must consider how this transition affects the nature of their relationship with their counterparties as potential debtors. The Panamanian insolvency system, we consider, provides a more welcoming business environment in Panama, as it is an incentive for companies to stay in business and, therefore, continue to provide jobs and economic activity.

Without a doubt, there are many conceptual and practical elements to analyse in Law 12 of 2016. However, as is often the case, only through the practice and application of this law has allowed both lawyers and financial institutions to fully grasp the challenges ahead. Regardless of the above, the objective of the Law is positive – especially since, previously, a bankruptcy declaration was a de facto death knell for a company. It is, therefore, worthwhile to focus efforts on maximising the advantages created under the law in order to obtain the desired results. These, however, will ultimately depend to a large extent on the good will and good faith dealings of both creditors and debtors.