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Similarities and Differences Between the EU Preventive Restructuring Framework Directive and the Restructuring Insolvency Proceeding in Colombia

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Abstract

The development of the world-wide pandemic caused by COVID-19 has generated wide interest in developing more tools available to help financially distressed businesses; however, as it is going to be shown, the interest is not new. Among the globe, legal systems contain provisions regarding proceedings under insolvency law and governed by it, which can be initiated to solve the economic circumstances of a debtor in financial distress. Reorganization and liquidation proceedings are most of the times included in these formal insolvency proceedings, however, there has been growing interest among regulators and legislators in providing another kind of solutions, aiming for effectiveness of businesses' recovery.

This paper focuses on the analysis of two insolvency frameworks, on one hand, the European Union Directive 2019/1023 on preventive restructuring frameworks (PRF), and on the other hand, the Colombian Insolvency Regulation, focusing almost exclusively on reorganization proceedings.

The goal of both regulations is to enable debtors in financial difficulties at an early stage to continue their business, however each has its own approach and requisites. On one hand, the EU Directive establishes a more flexible procedure, providing tools to debtors and creditors, which are seeking reach an agreement and restructure liabilities; on the other hand, the Colombian legislation ensures a financial equilibrium of the enterprise by establishing an automatic stay on of individual enforcement actions, creating a level playing field in which both, debtor and creditors, are called to negotiate in order to reach an agreement.

By analyzing the characteristics of both frameworks and considering the reported efficacy of the CIR by data provided by official authorities, this paper aims to establish which instruments or tools would be useful in order to make the CIR more effective towards the goal of enabling debtors in financial difficulties at an early stage to reorganize their debts and pursue their business.

Contents

I. Introduction

When a debtor fails to pay a debt or liability, legal systems provide creditors with laws that allow them to collect their unpaid debts. Such debt-collection law is focused on providing a remedy to a singular creditor, which might not serve the best interest in case of a debtor in financial distress who is failing to pay not just one debt, but most of its liabilities as they become due. That is why legal systems also provide legal mechanisms to "address the collective satisfaction of the outstanding claims"[1] from a debtor's assets, while preserving the going-concern value, avoiding settling down for a breakup value.

This way of grouping debtor and creditors in one procedure is one of the novelties of what is called as insolvency law, in contrast with the debtor-creditor approach. The first evident aim of both systems is to let creditors collect their unpaid debts, the latter in a singular way, while the former in a collective manner, grouping if not all creditors and debts, at least most of them, placing them all on an equal footing. Business recovery is an interest among governments to protect the economy and the actors involved from financial crisis which, if not handled correctly, could become a snowball in economic development and growth.[2]

Among the globe, legal systems contain provisions regarding proceedings under insolvency law and governed by it which can be initiated in order to solve the economic circumstances of a debtor in financial distress. Reorganization and liquidation proceedings are most of the

[1] United Nations Commission on International Trade Law, 'UNCITRAL Legislative Guide on Insolvency Law' (2004) A/Res/59/40, 9

[2] "High levels of non-performing loans have a direct consequence on banks' capacity to support growth". Commission, 'Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU' (2016) 723 final

times included in these formal insolvency proceedings, which address collective satisfaction of outstanding claims, one by allowing the debtor "overcome its financial difficulties and resume or continue normal commercial operations"[3], and other by "terminating the commercial activity of the debtor, realizing its assets as quickly as possible, distributing the proceeds proportionately to creditors."[4]

Recently, there has been growing interest among regulators and legislators in providing another kind of solutions, aiming for effectiveness of businesses' recovery. In many legislations and model frameworks there has been an introduction of rescue-oriented mechanisms for financially distressed agents or businesses. These procedures are the result of a mixture between the traditional reorganization procedures in an informal and more effective one, where not all creditors are involved, but most affected ones, giving access to businesses and creditors to new tools, with no or very limited court involvement. This new kind of approach to insolvency difficulties has been identified as "pre-insolvency" procedures.

The Colombian legislation in the matter is a clear example of formal insolvency proceedings. According to Law 1116 of 2006 by which "the business insolvency regime is established in the Republic of Colombia and other provisions are issued" (Colombian Insolvency Regime- CIR), the legislator took a traditional approach of how to address collective satisfaction of debts regarding financially distressed debtors.

The new European Union Directive 2019/1023 on preventive restructuring frameworks (PRF) is a clear example of the abovementioned new approach of implanting more rescue-

[3] United Nations Commission on International Trade Law, 'UNCITRAL Legislative Guide on Insolvency Law' (2004) A/Res/59/40, 27
[4] United Nations Commission on International Trade Law, 'UNCITRAL Legislative Guide on Insolvency Law' (2004) A/Res/59/40, 30

oriented mechanisms under insolvency law. The Directive, among other topics, designs a mechanism on which businesses can rely on in case they find themselves in a situation of "likelihood of insolvency". This Directive, and in particular the PRF, was the product of an extensive study of how to approach business failure and insolvency[5], which was first addressed in the Recommendation of the European Commission "on a new approach to business failure and insolvency"[6].

The purpose of this study is to revise the CIR, in parallel with the PRF implemented by the European Union, with the goal of trying to find the best characteristics that should be present in the design of a more effective insolvency mechanism, aiming to rescuing businesses in financial difficulties. The comparative analysis is going to be focused on the so-called traditional approach of reorganization proceedings designed by the CIR and, on the other hand, the newly pre-insolvency procedure designed by the European Union established in the Directive (EU) 2019/1023 - PRF. The goal of both regulations is to enable debtors in financial difficulties at an early stage to continue business, however each has its own approach and requisites.

This paper first discusses the general guidelines of insolvency proceedings, dedicated especially in rescue-oriented mechanisms, such as reorganization proceedings. Then, analyzes in detail first, the EU Directive on PRF and last, the CIR, focusing on rescue-oriented

[5] Commission, 'Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU' COM (2016) 723 final
Judith Dahlgreen and others, Study on a new approach to business failure and insolvency Comparative legal analysis of the Member States' relevant provisions and practices (Publications Office of the European Union 2016)
[6] Commission (EC), 'Recommendation on a new approach to business failure and insolvency' (Recommendation) (2014) 135

mechanisms provided by the framework, and finally addresses the measures considered appropriate to increase the efficiency of proceedings.

II. Theoretical background: General objectives of restructuring frameworks

Insolvency proceedings have a main objective which is the maximization of value of the enterprise or business. The decision of whether the debtor should go to liquidation and reach a near-term debt collection (which means the winding up of the company or break-up value of the business), or through a reorganization proceeding preserving the value of the business, maximizing the value of debtor (as an enterprise) to economy and society, is a public policy issue.

Establishing whether the business of the financially distressed debtor is viable should determine which kind of proceedings are to be sought (between reorganization and liquidation proceedings). This can only be established after a financial assessment of the debtor has been made, which most of the times encourages debtors to seek for financial or legal relief in case of foreseen financial difficulties.

In case the business or enterprise is no longer viable, an efficient liquidation process should be sought to maximize the recoveries and the break-up value of the debtor's assets. Such prompt determination helps increase creditor's recoveries in their own benefit.

When the enterprise is viable, which means that its line of business may continue generating profit, it is a fact that the debtor's assets ought to be kept as a unit of business, instead of opting for a wind-up value. This alternative preserves jobs, provides creditors with a better chance of recovering their whole unpaid debts (or a greater portion compared with what

they would get it the business was liquidated), and keeps the economy running and growing[7].

1. What is "insolvency"?

Before analyzing which are the main characteristics of reorganization proceedings, it is mandatory to know which debtors are allowed to commence this kind of proceedings or, in other words, which is the basis for opening an insolvency proceeding. The standard that must be satisfied to trigger the beginning or to be admitted to an insolvency framework is established by the law and mostly differ on whether the proceeding aims for the reorganization of the business or its liquidation instead.

Most legal frameworks establish that for an insolvency proceeding to be started with all its implications and consequences, the debtor must be in some important financial distress. This "financial distress" means that the debtor is required to be insolvent. "Insolvency" is defined in UNCITRAL's Legislative Guide as "when a debtor is generally unable to pay its debts as they mature or when its liabilities exceed the value of its assets"[8].

How to establish whether a debtor is insolvent is a matter of legal definition. There are two kinds of tests which may be used in order to determine the insolvency state of a business, as implied in the above mentioned UNCITRAL definition; the cessation of payments and

[7] Judith Dahlgreen and others, Study on a new approach to business failure and insolvency Comparative legal analysis of the Member States' relevant provisions and practices (Publications Office of the European Union 2016).
[8] United Nations Commission on International Trade Law, 'UNCITRAL Legislative Guide on Insolvency Law' (2004) A/Res/59/40

the balance sheet test, or by last, a combination of both. Insolvency, therefore, is the financial state of a debtor who is unable to pay its debts according to a cash flow test or a balance sheet test (or a mixture of both, according to each national legislation).

The cessation of payments or cash flow test requires that the debtor be "unable to meet its obligations as they fall due"[9]. Some requirements or specifications may be added to the test in order to establish the insolvent state of the debtor, such as the inability of the debtor to pay more than one obligation to more than one creditor for more than 30 days, or its inability to pay a number of consecutive salary payments to its employees, or the inability of the debtor to raise any credit in order to cover the debts that have become due.

On the other hand, the balance sheet test establishes that "where the value of a company's assets is less than the amount of its liabilities, taking into account both contingent and prospective liabilities"[10], that company is technically insolvent. By the means of this test, a snapshot of the company's balance sheet is taken as the request of commencement of the insolvency proceeding is requested. However, it might not be the best way of establishing a business' insolvency and probability of success, as the doctrine has shown[11].

By implementing an eclectic approach, many jurisdictions have applied a more dynamic test, including aspects of both, cash-flow and balance sheet tests. As it was shown by the

[9] United Nations Commission on International Trade Law, 'UNCITRAL Legislative Guide on Insolvency Law' (2004) A/Res/59/40, 47

[10] Kubi Udofia, 'Establishing Corporate Insolvency: The Balance Sheet Insolvency Test' (SSRN Dr Kubi Udofia, 19 March) [2019] <http://dx.doi.org/10.2139/ssrn.3355248> accessed 2 March 2021

[11] Kubi Udofia, 'Establishing Corporate Insolvency: The Balance Sheet Insolvency Test' (SSRN Dr Kubi Udofia, 19 March) [2019] <http://dx.doi.org/10.2139/ssrn.3355248> accessed 2 March 2021 and United Nations Commission on International Trade Law, 'UNCITRAL Legislative Guide on Insolvency Law' (2004) A/Res/59/40, 47

European Commission in a 2016 Study[12], the insolvency test in Austria "involves consideration of ability to pay debts in the future, say up to 2 years (Austria), and if events can be foreseen even further into the future, e.g. the maturity of a loan in 10 years' time". Also, in countries such as Ireland and the United Kingdom, the Courts have a bigger power in establishing whether the company is likely to trade out of its difficulties and continue its business, in order to decide what suits best, if to make a winding up order or an administration order.[13]

As an example, the Colombian Insolvency Regime adopted an eclectic approach, by which a debtor is in cessation of payments when it fails to pay for more than ninety days, two or more obligations in favor of two or more creditors, or has at least two execution proceedings filed by two or more creditors for the payment of obligations. However, it added a balance sheet approach by indicating that, in any case, the accumulated value of the unpaid liabilities must represent at least ten percent (10%) of the total liability of the debtor.[14]

In particular, in the European Union, defining what is considered as "insolvency" is exclusive competence of each Member State, and such definition cannot be established by the European Union itself. Its difficulty with defining the matter has created an evident gap in the harmonization of core aspects of insolvency law, which as a matter of fact would be

[12] Judith Dahlgreen and others, Study on a new approach to business failure and insolvency Comparative legal analysis of the Member States' relevant provisions and practices (Publications Office of the European Union 2016), 185
[13] BNY Corporate Trustee Services Ltd v Eurosail – UK 2007-3JBL plc [2013] UKSC 28.
[14] Ley 1116 de 2006. Diario Oficial No.46.494 Por la cual se establece el Régimen de Insolvencia Empresarial en la República de Colombia y se dictan otras disposiciones, Bogota 27 de diciembre de 2006 art 9

useful for achieving legal certainty and avoiding forum-shopping in insolvency issues among Member States.[15]

2. What is "pre-insolvency"?

Some legislations, however, make insolvency proceedings available for debtors that are not currently in a state of insolvency (according to the implemented test - cessation of payments of balance sheet or hybrid), but that might be incurred in an insolvent state in the future if measures are not taken. Such scenarios are covered by legislations as "likelihood of insolvency", "pre-insolvency" or "prospective illiquidity", among others.

By enabling restructuring procedures (formal or informal) in pre-insolvency scenarios, the frameworks are aiming for maximizing the total value of the debtor's assets, by maintaining the business as a unitary economic value, avoiding unnecessary job losses, and preventing the snowballing of nonperforming loans and, hence benefitting the wider economy. By this, debtors are called to be more aware of possible financial difficulties and at the same time are encouraged to take early action, which would mean that their insolvency may be prevented, and their business pursued.

[15] "Inefficiencies and differences in national insolvency frameworks generate legal uncertainty, obstacles to recovery of value by creditors, and barriers to the efficient restructuring of viable companies in the EU, including for cross-border groups." Commission, 'Capital Markets Union - Accelerating Reform' COM (2016) 601 final, 3

In words of the European Commission, "[t]he earlier the debtor can detect its financial difficulties and can take appropriate action, the higher the probability of avoiding an impending insolvency or, in case of a business whose viability is permanently impaired, the more orderly and efficient the winding-up process"[16].

Like the definition of insolvency, the definition of "likelihood of insolvency" or "pre-insolvency" is not uniform over legislations and therefore depends on the regulatory framework under study. However, the key element in the concept is future; the probability or chance of the debtor on becoming insolvent in a short, medium or long term, depending on the circumstances.

Under "pre-insolvency" circumstances, depending on the legal system, the debtor may be able to gather with its creditors in a procedure in order to restructure its liabilities, making an early intervention at the first signs of distress. In simple words, it is the ability to access to debt-restructuring frameworks established by the law before the debtor becomes insolvent, with the aim of avoiding it.[17]

In the regulatory frameworks under analysis, in case of the EU 2019/1023 Directive, the "likelihood of insolvency" state opens the door to a "preventive restructuring framework"; or under the Colombian Insolvency Regime, in case of a state of "impending insolvency", is viable to start a reorganization proceeding.

[16] Commission, 'Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU' COM (2016) 723 final, 27

[17] Irit Mevorach and Adrian Walters, 'The Characterization of Pre-insolvency Proceedings in Private International Law' [2020] 1(21) European Business Organization Law Review <https://doi.org/10.1007/s40804-020-00176-x> accessed 3 April 2021, 858

The interest on timely preventive restructuring procedures has risen in public policy affairs, with bodies such as the United Nations Commission on International Trade Law – UNCITRAL[18] and The World Bank[19], promoting uniform legislations aiming for an effective preventive restructuring framework open to debtors in possible financial difficulties or distress in the future.

3. Characteristics of restructuring frameworks

According to the World Bank and its "Principles for Effective Insolvency and Creditor/Debtor Regimes", restructuring or reorganization proceedings "should permit quick and easy access to the process, protect all those involved, permit the negotiation of a commercial plan, enable a majority of creditors in favor of a plan or other course of action to bind all other creditors (subject to appropriate protections), and provide for supervision to ensure that the process is not subject to abuse"[20]. How to reach those goals depends primarily in how the process is designed, and which are to be taken as milestones in order to protect every party involved or affected by the reorganization of the debtor's business.

As an all-in-one proceeding, it seeks for the best of interests of all parties, including the business (preserving human resources, business relations and benefiting society as a whole). Indeed, the aim of this kind of proceedings is to preserve businesses by reorganizing the enterprise or business of the debtor so that it can be viable and profitable.

[18] United Nations Commission on International Trade Law, 'UNCITRAL Legislative Guide on Insolvency Law' (2004) A/Res/59/40
[19] The World Bank, 'Principles for Effective Insolvency and Creditor/Debtor Regimes' [2016]
[20] The World Bank, 'Principles for Effective Insolvency and Creditor/Debtor Regimes' [2016] 8

The businesses' reorganization may take different forms in order to reach its goal, for example by restructuring the debts (extending the length of the loan, changing the identity of the lenders, getting the creditors to agree to get a percentage of the debts owed and not the whole), converting debt into equity, selling non-essential assets, and infusion of new finance. All these ways, among much other and combinations of them, give the debtor some space to recover from its financial difficulties and move on with its business.

According to UNCITRAL's Legislative Guide on Insolvency Law, the following are some remarked characteristics of reorganization proceedings, which may be found in most legal frameworks that include reorganization or restructuring as a kind of insolvency proceeding:

> "(…)
> (b) Automatic and mandatory stay or suspension of actions and proceedings against the assets of the debtor affecting all creditors for a limited period of time;
> (c) Continuation of the business of the debtor, either by existing management, an independent manager or a combination of both;
> (d) Formulation of a plan that proposes the manner in which creditors, equity holders and the debtor itself will be treated;
> (e) Consideration of, and voting on, acceptance of the plan by creditors;
> (f) Possibly, the judicial approval or confirmation of an accepted plan."[21]

The above listed characteristics can be grouped in three different categories: Stay of individual enforcement actions, continuation of the business of the debtor (most of the times

[21] United Nations Commission on International Trade Law, 'UNCITRAL Legislative Guide on Insolvency Law' (2004) A/Res/59/40

implying a debtor-in-possession model) and the existence of a restructuring plan. By explaining these three groups of characteristics, one can have a general idea of what should be expected from this kind of proceedings.

a) Stay of individual enforcement actions

When an application has been filed or the reorganization proceeding has started (which depends specifically on how the legislation defines the commencement of the proceedings), there is a call for the debtor and its creditors to gather around the negotiation of a reorganization of the assets, liabilities and business of the debtor. Since restructuring proceedings are designed to keep a business alive so that this additional value can be captured[22], allowing creditors to seize the debtor's assets would not be the best way of reaching that goal.

As explained above, the debtor must be in a state of insolvency or prospect insolvency to be eligible for this kind of proceedings and in that particular situation is when an "uncoordinated cascade of individual enforcement actions threatens to occur, which actions need to be coordinated through a collective process to maximize recoveries for the creditors as a whole"[23], and that "collective process" is the reorganization proceeding.

The stay's aim is to prevent uncoordinated individual enforcement actions, which means that creditors are uncapable to enforce their rights or securities against the debtor or its

[22] Judith Dahlgreen and others, Study on a new approach to business failure and insolvency Comparative legal analysis of the Member States' relevant provisions and practices (Publications Office of the European Union 2016), 230
[23] Nicolaes Tollenaar, Pre-Insolvency Proceedings: A Normative Foundation and Framework (Oxford University Press 2019), 196

assets, either because of the suspension of existing actions or by a moratorium on the commencement of new ones.[24] It supports the negotiations of a restructuring plan during the proceedings, helps the debtor continue operating its business and preserves the estate's value.[25]

In a first shallow view, it could be claimed that it adversely impacts the individual position of creditors because their ability to enforce their claims is restricted; however, at the end it serves the whole creditor's interests by facilitating "a coordinated realization and distribution of the available value"[26].

The stay can be general, which means that every single creditor is unable to enforce its rights against the debtor, or it can be applied solely to some individual creditors or categories of creditors. In other words, the stay may be applicable to all creditors or to some of them.

Also, the stay can be automatic (or by operation of law) or discretionary. The stay is automatic when individual enforcement actions from creditors are not to be commenced or continued against the debtor or its assets as soon as the proceeding is understood to have begun under the law. It is discretionary when upon request of the debtor or its creditors it can be granted by a judicial or administrative authority.

[24] United Nations Commission on International Trade Law, 'UNCITRAL Legislative Guide on Insolvency Law' (2004) A/Res/59/40, 83

[25] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency) [2019] OJ L172/26, para 32

[26] Nicolaes Tollenaar, Pre-Insolvency Proceedings: A Normative Foundation and Framework (Oxford University Press 2019), 195

Whether the stay is to be general or specific, automatic or granted upon request, depends on the legislative framework. Nevertheless, it is called to be a temporal measure taken in the procedure's framework during the negotiation of the plan and it should not last longer than is strictly necessary.

b) Continuation of the business of the debtor

As it was explained above, in the case a financial distressed business is considered to be viable and a reorganization proceeding takes place instead of the liquidation of the business, it's a fact that the debtor's assets ought to be kept as a unit of business, and the enterprise shall continue as a player in the market.

It is important to make clear that the continuation of the debtor's business does not imply *per se* the involvement of the debtor on its business. The role of the debtor during the reorganization proceeding (and even during the implementation of the plan) is to be established by the law. Legal systems approach the matter in different ways, by displacing the debtor and appointing an IP (insolvency professional) representative, or by allowing the debtor to remain in control of the business, or somewhere in between those two.[27]

Whether the legal framework establishes a debtor-in-possession regime or the appointment of an IP representative has nothing to do with the reorganization plan itself. The involvement of the debtor on the business does not give the debtor control over the design or implementation of the plan, because it only means that the debtor "retains control over the

[27] United Nations Commission on International Trade Law, 'UNCITRAL Legislative Guide on Insolvency Law" (2004) A/Res/59/40, 163

ordinary course of business and the working capital used in that ordinary course"[28], and its involvement in the direction of the company or business may be sometimes crucial for the reorganization and success of the proceedings.

c) Reorganization plan

The final goal of a reorganization proceeding is, as the mere name implies, reorganize the debtor's business in order to rescue it from liquidation, letting it pay its debts in a negotiated manner. The vehicle to reach such goal is a reorganization plan, with which the capital structure of a company is restructured in order to make the business viable again.[29]

The matter of how that objective is reached is to be covered in the reorganization plan. Such plan may involve the continuance of the debtor's business so that creditors are rapidly re-paid, which might comprise an agreement to pay creditors not their whole claims but just a percentage over a certain period of time. Another option could involve equity distribution of the business among creditors, which would involve a reform of the corporate structure of a company.[30] Options such as an eventual sale of the business as a going concern, or the disposal of all or part of the estate owned by the debtor, or a merger with other business are also part of the landscape of possibilities to be integrated in a reorganization plan.

[28] Nicolaes Tollenaar, Pre-Insolvency Proceedings: A Normative Foundation and Framework (Oxford University Press 2019), 193

[29] "The purpose of reorganization is to maximize the possible eventual return to creditors, providing a better result than if the debtor were to be liquidated and to preserve viable businesses as a means of preserving jobs for employees and trade for suppliers.". United Nations Commission on International Trade Law, 'UNCITRAL Legislative Guide on Insolvency Law" (2004) A/Res/59/40, 209

[30] United Nations Commission on International Trade Law, 'UNCITRAL Legislative Guide on Insolvency Law" (2004) A/Res/59/40, 210

When and who should present a proposal depends on the legislative framework. For example, some legislations provide that a reorganization plan should be presented with the application for reorganization proceedings. As to who has the right to present a plan proposal, some laws state that all parties involved (debtor, creditor and even the IP representative – if any), have a positive obligation to cooperate in both states, negotiating and proposing a plan. As an example, the Colombian Insolvency Regime provides that the debtor shall file a plan with the application for reorganization proceedings.[31]

The content of the plan and the way it is to be approved is a legislation matter and falls out of the scope of this study. However, issues related to which creditors are entitled to vote on the plan, if it may affect dissenting creditors or classes, and the support given to the concerns covered by the plan are key aspects to its success and the final company economic recovery.

[31] Ley 1116 de 2006 art 13.6

III. The EU Directive 2019/1023 on preventive restructuring frameworks

As it was explained above, traditional or formal insolvency procedures (such as reorganization or liquidation proceedings based on a cash flow or balance sheet insolvency) have been adapted with the objective of giving economically viable debtors the chance to restructure their debts early enough, when they find themselves in financial difficulties, before they enter to an insolvent state. That objective has been molded in informal, short length proceedings with low costs, aiming to preserve viable businesses, or to reach an efficient and orderly liquidation process in case the business is not sustainable any longer.

The interest on timely preventive restructuring procedures has risen in public policy affairs, with bodies such as the United Nations Commission on International Trade Law – UNCITRAL and The World Bank, promoting uniform legislations aiming for an effective preventive restructuring framework open to debtors in financial difficulties or distress. These procedures are the result of a mixture between the traditional reorganization procedures in an informal and more effective one, where not necessarily all creditors are involved, and the 'insolvency' requirement is approached in a different way.

The European Commission, seeking to facilitate a rescue culture within the Union, promoting investment, entrepreneurship and employment, and following this "new trend", in 2014

adopted a Recommendation[32] for Member States to approach in a different way business failure and insolvency.[33]

The Commission Recommendation "on a new approach to business failure and insolvency", called upon Member States to modernize their insolvency frameworks in order to make an efficient restructuring proceeding available for viable enterprises in financial difficulties. In fact, it encouraged Member States for a greater coherence between national insolvency frameworks to reduce inefficiencies and remove barriers to effective restructuring of viable enterprises in financial difficulties at an early stage. Its core philosophy was based on a balance of interests of all parties involved in the insolvency proceeding while promoting business rescue.

According to the Recommendation, such thing could be reached by putting in place a framework that was focused mainly on restructuring plans instead of the liquidation of the business. Some elements of the proposed framework were debtor-in-possession of the business while the procedure took place, temporary stay of enforcement actions, minimum court involvement and protection of new financing necessary for the implementation of a restructuring plan.[34]

[32] Commission (EC), 'Recommendation on a new approach to business failure and insolvency' (Recommendation) (2014) 135
[33] Michael Veder and Anne Mennens, 'Preventive Restructuring Frameworks' in Busch and others (eds), Capital Markets Union in Europe (Oxford University Press 2018), 558.
[34] Commission (EC), 'Recommendation on a new approach to business failure and insolvency' (Recommendation) (2014) 135, III. A. 6. "Availability of a preventive restructuring framework".

Unfortunately, as the Evaluation[35] of the Implementation of the Commission Recommendation showed, the Recommendation did not lead to massive, coordinated insolvency regimes reforms among the Member States. The evidence showed that there was an "incomplete and inconsistent implementation of the Recommendation."[36]

However, in spite of the lack of implementation[37] of the Recommendation or the unwillingness of Member States to adopt or adapt their insolvency frameworks[38] in order to enable enterprises to restructure at an early stage, the Commission announced its intention to present a "proposal on business restructuring and second chance, key elements of an appropriate insolvency framework" [39] in its Capital Markets Union Action Plan in September of 2016. Through a binding instrument in the form of a Directive, Member States would remain flexible in the way of adopting it, while the principles and rules were set out directly by the European Union.[40] Such intention resulted in the approval of the Directive 2019/1023.

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[35] Commission Staff Working Document, 'Impact Assessment: Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU' (2016) 357 final , 7 '… while the Recommendation has provided useful focus for those Member States undertaking reforms in the area of insolvency, it has not led to the desired impact in terms of consistent changes across all Member States, facilitating the rescue of businesses in financial difficulty and in giving a second chance to entrepreneurs. This was due to its partial implementation in a significant number of Member States, including those having launched certain reforms'.

[36] Judith Dahlgreen and others, Study on a new approach to business failure and insolvency Comparative legal analysis of the Member States' relevant provisions and practices (Publications Office of the European Union 2016), 223

[37] 'It is not very surprising that the evaluation of the implementation of the Recommendation showed that it did not produce the results the European Commission had hoped for. Several Member States indicated to the Commission that they considered that they already largely complied with the Recommendation and a significant number of Member States that did not comply had not launched any reforms. The Recommendation did not lead to the desired coordinated EU-wide insolvency reforms.' Michael Veder and Anne Mennens, 'Preventive Restructuring Frameworks' in Busch and others (eds), Capital Markets Union in Europe (Oxford University Press 2018), 558

[38] About the failure of the Recommendation, "Member States ignoring the Recommendation might have done so because they believe in the benefits of regulatory diversity (and regulatory competition), because they consider to already have efficient pre-insolvency restructuring frameworks in place and/or because they think that the Recommendation contains serious regulatory flaws". Horst Eidenmuller, 'What Is an Insolvency Proceeding' [2018] 92 Am Bankr LJ 53.

[39] Commission, 'Action Plan on Building a Capital Markets Union' COM (2015) 468 final, 3

[40] Emilie Ghio, 'Case Study on Cross-border Insolvency and Rescue Law: an Analysis of the Future of European Integration' [2017] 20(1) Irish Journal of European Law 63, 72

The Directive is centered in three main topics, as follows: i) Preventive restructuring procedures; ii) insolvency and discharge of debt; and iii) measures to increase the efficiency of insolvency procedures in general. In the following lines, the main goals and the basic elements of the Directive are going to be discussed, regarding the preventive restructuring framework designed by the Commission.

1. Objectives of the Directive

The Directive designs a mechanism in which businesses can rely on in case they find themselves in a situation of "likelihood of insolvency". It establishes substantive minimum standards for preventive restructuring procedures among the Member States of the European Union. With its implementation, businesses located in the European Union are ensured access to a preventive restructuring procedure that enables them to restructure their debts at an early stage of financial distress or, as the Directive establishes, when found in a state of "likelihood of insolvency".

Rescuing a business ensures the preservation of jobs, "provides creditors with a greater return based on higher going concern values of the enterprise, potentially produces a return for owners, and obtains for the country the fruits of the rehabilitated enterprise"[41]. It has been found that such rescue can be reached when the enterprise is effectively restructured at an early stage, which means that insolvency *per se* is avoided, which ends up being the purpose of preventive restructuring procedures[42] and the main goal of the Directive.

[41] The World Bank, 'Principles for Effective Insolvency and Creditor/Debtor Regimes' [2016]
[42] "The purpose of the preventive restructuring procedures is to enable enterprises to restructure at an early stage and to avoid insolvency." Nicolaes Tollenaar, 'The European Commission's Proposal for a Directive on Preventive Restructuring Proceedings' [2017] 30(5) Insolvency Intelligence 65, 65

As the Treaty of the Functioning of the European Union states, the Union "shall adopt measures with the aim of establishing or ensuring the functioning of the internal market"[43], defining internal market as "an area without internal frontiers in which the free movement of goods, persons, services and capital is ensured"[44].

Having in perspective the aim of reaching and ensuring an internal market, the Directive's main achievement is to:

> "… remove obstacles to the exercise of fundamental freedoms, such as the free movement of capital and freedom of establishment, which result from differences between national laws and procedures concerning preventive restructuring, insolvency, discharge of debt, and disqualifications."[45]

The Directive sets out a uniform general framework (which removes barriers within the Union), to allow debtors to restructure their liabilities before facing insolvency, which prevents unnecessary job losses and losing know-how, while maximizing the total value to creditors. Hence, it is better to reorganize a business at an early stage and making it viable, than winding it up because the level of insolvency made it become unsustainable or unviable.

[43] Consolidated version of the Treaty on the Functioning of the European Union [2012] OJ C326/13 art 26.1
[44] Consolidated version of the Treaty on the Functioning of the European Union [2012] OJ C326/13 art 26.2
[45] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency) [2019] OJ L172/26

Two snow-ball effects can be prevented by the implementation of early restructuring proceedings. On one hand, it prevents the build-up of non-performing loans, which means that it reduces "the risk of loans becoming non-performing in cyclical downturns and mitigating the adverse impact on the financial sector"[46]. On the other hand, it decreases the risk of domino-effect insolvencies[47] to happen, issue which clearly has an impact on the functioning of the internal market.

All things considered, by establishing a higher degree of harmonization[48] and by ensuring the access to a preventive restructuring proceeding among all Member States decreases the costs while assessing the risk for investing among the European market. In essence, by establishing a preventive restructuring framework, the main objectives are:

> "… help increase investment and job opportunities in the single market, reduce unnecessary liquidations of viable companies, avoid unnecessary job losses, prevent

[46] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency) [2019] OJ L172/26

[47] The domino-effect insolvencies are defined by the Directive as those by which "a debtor's insolvency may trigger further insolvencies in the supply chain". Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency) [2019] OJ L172/26

[48] However, some scholars state that harmonization is not reached by the Directive, but just more comparable restructuring regimes among the European Union. 'It is doubtful that all of the above can actually be achieved with the Directive. Although, it can be assumed that the EU as a whole and the Internal Market will benefit from not fully harmonised, but, at least, more comparable insolvency and restructuring regimes. This should increase legal certainty and trust between Member States and facilitate cross-border restructurings (especially of enterprise groups)." Gottfried Gassner and Georg Wabl, 'The New EU Directive on Restructuring and Insolvency and its Implications for Austria' [2019] 13(2) Insolvency and Restructuring International 5, 6

the build-up of non-performing loans, facilitate cross-border restructurings, and reduce costs and increase opportunities for honest entrepreneurs to be given a fresh start".[49]

2. The "preventive restructuring framework": Likelihood of insolvency

The Directive sets out the rules of a restructuring framework in case of a likelihood of insolvency, "with a view to preventing the insolvency and ensuring the viability of the debtor"[50]. Based on the Directive, Member States shall make a restructuring framework available for debtors before they become insolvent under national law. In other words, this framework aims for the restructuring of debts and businesses before the debtor fulfils the conditions for entering a collective formal insolvency proceeding, regarding national law.[51]

This kind of pre-insolvency proceedings is designed in order to provide economically viable debtors in financial distress (mostly in cases of imminent cash-flow insolvency) with a formal negotiating procedure and enforceable agreement with their principal creditors (not necessarily all of them), to get more favorable terms without compromising its viability and continuance in the market.[52]

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[49] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency) [2019] OJ L172/26

[50] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency) [2019] OJ L172/26 art 1.1.a

[51] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency) [2019] OJ L172/26 para 24

[52] Irit Mevorach and Adrian Walters, 'The Characterization of Pre-insolvency Proceedings in Private International Law' [2020] 1(21) European Business Organization Law Review <https://doi.org/10.1007/s40804-020-00176-x> accessed 3 April 2021, 861-862

The availability of these pre-insolvency proceedings designed by the Directive is justified only in case of a likelihood of insolvency of the debtor, in contrast with the availability of other restructuring proceedings in other parts of the world, such as Chapter 11 in the United States.[53] Specifically, article 4 of the Directive states the following:

> '1. Member States shall ensure that, **where there is a likelihood of insolvency, debtors have access to a preventive restructuring framework** that enables them to restructure, with a view to preventing insolvency and ensuring their viability, without prejudice to other solutions for avoiding insolvency, thereby protecting jobs and maintaining business activity.'[54]

In this regard, the Directive expressively lays down the minimum scope of application of the framework to debtors in a particular financial situation, which corresponds to a likelihood of insolvency. As this kind of procedures are a step before of the insolvency of the debtor where creditors would be entitled to exercise their collective enforcement rights in an insolvency procedure, the access to it is limited exclusively to debtors in a financial state that would inevitably involve insolvency anytime in the future.

[53] Horst Eidenmuller, 'What Is an Insolvency Proceeding' [2018] 92 Am Bankr LJ 53 'For initiating a Chapter 11 proceeding "insolvency" is not a requirement. However, most courts do recognize a good faith requirement which,in turn, reflects a concern about common pool problems'

[54] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency) [2019] OJ L172/26 art 4.1 Availability of preventive restructuring frameworks.

However, the term is too vague. What "likelihood" implies is not defined in the Directive and, instead, is left to Member States to outline it themselves.[55] In other words, national law is the one to define the term of "likelihood of insolvency" and therefore, the scope of application of the pre-insolvency framework created by the Directive is defined in each Member State.

Nevertheless, in the Commission's Impact assessment, it is set down some kind of a guideline that can be taken into account in order to understand what likelihood in this context means according to the Commission's goal while designing this framework. In the Commission's words, the term implies that "there must be a rational basis for the conclusion that the company may not be able to pay its debt within a certain period (such as within the next six months)"[56].

Regarding the above, it means that the term "likelihood" should be analyzed under a rational basis – applying some kind of test – while trying to predict the future financial state of the company within certain period of time. In fact, article 4.3 establishes that Member States may "maintain or introduce a viability test under national law", by which it is possible to exclude financially unviable debtors from the pre-insolvency procedure.

Therefore, each Member State while implementing the Directive is going to lay down its own test in order to make available for creditors to start a restructuring plan in case of pre-

[55] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency) [2019] OJ L172/26 art 2.2.b

[56] Pierre Hausemer and others, Impact assessment study on policy options for a new initiative on minimum standards in insolvency and restructuring law (Publications Office of the European Union 2017) 79

insolvency. This also means that the period of time taken into account to establish the likelihood of future financial distress of the debtor is going to vary depending on each jurisdiction.

As an illustration, the Directive was implemented in Germany, by the Law on the Stabilization and Restructuring Framework for Companies (StaRUG, Gesetz über den Stabilisierungs- und Restrukturierungsrahmen für Unternehmen), which came into force on January 1st, 2021. There the concept of "likelihood of insolvency" was defined as a state of imminent illiquidity (*drohende Zahlungsunfähigkeit*). Such state is considered to be triggered "when it is likely that the debtor will not be able to meet its future payment obligations that fall due over the next 24 months".[57]

In the German case, the Directive was transposed and the term "likelihood of insolvency" was defined under a rational basis as an imminent illiquidity which "exists if the debtor is not likely to be able to meet payment obligations at the time of maturity within a forecast period of 24 months"[58] (cash-flow analysis). However, the access to this framework was excluded to debtors who are over-indebted or are already insolvent.

In contrast, in the case of Spain, under the Recast Insolvency Law (Royal Legislative Decree 1 of 2020), there was made available an informal insolvency proceeding framework

[57] Adam Gallagher and others, 'The New German Preventive Restructuring Framework' [2021] American Bankruptcy Institute 50

[58] Scwp Schindhelm, 'EU Countries Facilitate Preventive Restructuring' (Scwp Schindhelm Newsletter, February 2021) <Internationaler_Newsletter_Restrukturierungsrichtlinie_EN_SCWP_AT.pdf (schindhelm.com)> accessed 18 May 2021

to debtors who are already insolvent (but who are not involved in formal insolvency proceedings), or in impending insolvency.[59] No further test was laid down by the legislation and it is to be stablished, case by case, whether the debtor is in actual state of insolvency or in impending insolvency.

However, such law doesn't transpose the Directive into national law, and it just lays down the primary grounds for it to be implemented under the Spanish legislation. The Directive was not incorporated into national law because the government argued an extreme difficulty in such process, as its Preamble states. Henceforth, an actual implementation of the Directive is currently not yet to be considered and as for February 2021 a draft law is not yet available.

It is a fact that, since the terms "insolvency" and "likelihood of insolvency" were not defined directly by the Directive, such terms are not harmonized and therefore, the pre-insolvency framework is going to be everything but uniform among Member States. What is going to be considered as the entrance requisite is not going to be the same among the European Union, since Member States opposed to harmonize the definition of the terms referred to.[60] In conclusion, that "likelihood of insolvency" will inevitably occur at different points of time, depending on how it has been defined under each national law.

3. Characteristics of the Preventive Restructuring Framework – PRF

[59] Royal Legislative Decree 1/2020, of 5 May 2020, approving the Consolidated Text of the Spanish Insolvency Law. Section 583.
[60] Michael Veder and Anne Mennens, 'Preventive Restructuring Frameworks' in Busch and others (eds), Capital Markets Union in Europe (Oxford University Press 2018), 565.

According to UNCITRAL, preventive restructuring frameworks combine "voluntary restructuring negotiations, where a plan is negotiated and agreed by the majority of affected creditors, with reorganization proceedings commenced under the insolvency law to obtain court confirmation of the plan in order to bind dissenting creditors"[61]. The aim of this kind of proceedings is to make the reorganization of debts less costly and more effective, and this is what the Directive tried to achieve while designing the PRF.

According to the Directive, this framework shall be available on application by debtors, leaving the option to Member States to make it available at the request of creditors and employees' representatives, but always subject to the debtor's consent. With this view, consequently, two features were included in the framework, first, early warning tools and, second, a debtor in possession scheme.

Regarding the "early warning tools", they aim to provide debtors with effective mechanisms that show signs of difficulties that could imply insolvency in the future. Such system should include internal and external monitoring to ensure effectiveness.[62] The Directive, in fact, included both as examples of which tools may be included by Member States, such as alerts "when the debtor has not made certain types of payments"[63], or incentives to third parties to flag the debtor in case of "bad [financial] development"[64].

[61] United Nations Commission on International Trade Law, 'UNCITRAL Legislative Guide on Insolvency Law" (2004) A/Res/59/40
[62] Pierre Hausemer and others, Impact assessment study on policy options for a new initiative on minimum standards in insolvency and restructuring law (Publications Office of the European Union 2017) 80
[63] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency) [2019] OJ L172/26 art 3.2.a
[64] ibid art 3.2.c

Concerning the debtor in possession scheme, as it was noted above, it means that the debtor "retains control over the ordinary course of business and the working capital used in that ordinary course"[65]. In the case under analysis, the Directive establishes that debtors may remain totally or partially in control of their assets and over the course of business.

Only in certain cases an IP is going to be appointed, even though the debtor may remain in partial control of the business. Article 5 establishes that the IP must be appointed in certain circumstances regarding sensitive matters (such as when a general stay is granted, or in case of a cross-class cramdown, where the restructuring plan is going to be confirmed by the competent authority; aspects that are going to be explored below).

The stay of individual enforcement actions, as showed above, is a key aspect of insolvency and pre-insolvency proceedings. In case of the PRF, the Directive does not establish an automatic stay; however, it makes a stay of enforcement actions available to debtors "to support the negotiations of a restructuring plan".

For a stay of individual enforcement actions to exist in this kind of proceedings, it needs to be granted by a judicial or administrative authority, and its necessity must be shown. In other words, the authorities may grant a stay if it is considered necessary for the implementation of a restructuring plan or if it is established that it would support the negotiations of such plan. Such "moratorium" gives the debtor a so-called breathing space during which negotiations about the restructuring may take place, while the debtor remains in possession of the business.[66]

[65] Nicolaes Tollenaar, Pre-Insolvency Proceedings: A Normative Foundation and Framework (Oxford University Press 2019) 193
[66] Nicolaes Tollenaar, Pre-Insolvency Proceedings: A Normative Foundation and Framework (Oxford University Press 2019) 568

The extent of the stay is to be established on a case-to-case scenario; nevertheless, it may cover all types of claims (secured and preferential claims included), and it can be general (covering all creditors) or limited to certain creditors or claims. Regarding the possible duration of the stay, for instance, it is limited to a period of four months; period that can be extended during the proceedings, but which cannot exceed the total duration of 12 months.

Another key characteristic of the PRF is that not all creditors are involved in the process, included in the restructuring plan nor affected by it. As articles 8 and 9 of the Directive establish, the plan needs to include information of the "claims or interests covered by the restructuring plan", which means that not every single debt or liability has to be included in it, and that it has to be ensured that "affected parties have a right to vote", while parties that are not affected "shall not have voting rights in the adoption of that plan".

Such issue is important because, in contrast with formal (or classic) insolvency proceedings where all assets and liabilities are affected or covered by the process and the plan, in this pre-insolvency proceeding, not all creditors or debts are to be restructured, affected or included in the restructuring process. Such differentiation has a huge impact in practice, since it means that just important creditors (e.g. in terms of liability size or business viability) are to be called by the debtor in order to discuss refinancing techniques for the business' viability sake.

In this sense, the Directive encourages debtors when financial or economic difficulties threaten to affect the business, to act early in order to negotiate with creditors aiming for a

restructuring deal, however not with all of them. As is, the restructuring plan "may be offered to all creditors and equity holders, but it can also be directed to specific classes of creditors and/or equity holders"[67], reminding that the aim of the procedure is to remedy the underlying causes of the likelihood of insolvency of the debtor or, in other words, the causes of financial distress.

As not all creditors are included in the pre-insolvency proceeding, not all of them are going to be included in the reorganization plan. In consequence, it means that unaffected parties might not even know about the ongoing negotiations, and don't have a say in it, since they are not involved in the proceedings.

As article 9 of the Directive establishes, affected parties shall be treated in separate classes according to the criteria, and only affected parties have voting rights. The plan is accepted if a majority of favorable votes is reached within each class of creditors and, most importantly, even dissenting parties are bind by the approved plan.

Regarding dissenting parties (dissenting minorities within a class or dissenting class), we would like to point out just that the plan is deemed to be adopted if it is confirmed by a court. It means that, according to the PRF, a "cram-down of dissenting creditors" and a "cross-class cram down" are possible.[68]

[67] Michael Veder and Anne Mennens, 'Preventive Restructuring Frameworks' in Busch and others (eds), Capital Markets Union in Europe (Oxford University Press 2018) 573
[68] For further analysis, Michael Veder and Anne Mennens, 'Preventive Restructuring Frameworks' in Busch and others (eds), Capital Markets Union in Europe (Oxford University Press 2018)

IV. Analysis of the Colombian restructuring Insolvency legislation (Ley 1116 de 2006)

The Colombian legal system has a long-term developed insolvency framework. With modifications and improvements, insolvency proceedings were regulated by Law 222 of 1995 and 550 of 1999, system that was completely substituted by Law 1116 of 2006, named as the "Corporate Insolvency Regime". This new framework established a new insolvency system and determined new legal procedures for traders and corporations, in reorganization and liquidation proceedings.

This chapter is going to describe the Colombian insolvency framework, in particular the restructuring or reorganization proceedings. It is going to focus on the objectives of restructuring proceedings, the scope of application of such proceedings and its characteristics.

1. Principles and objectives of the Colombian insolvency framework

Law 1116 of 2006 established a single judicial bankruptcy regime for both, the recovery mechanism (reorganization process), and the liquidation mechanism (judicial liquidation). The intervention or presence of a judge provides security to the creditors and the debtor, publicizes the process and generates transparency, which facilitates the negotiation of the agreement or the maximization of the liquidation of the debtor's assets.[69]

[69] Juan Jose Rodriguez Espitia, Nuevo Regimen de Insolvencia (2nd edn, Universidad Externado de Colombia 2019) 24

As article 1 of Law 1116 establishes, the main goal of the insolvency framework is "credit protection" while safeguarding and preserving the enterprise as a "unity of economic exploitation and generator of employment", through both proceedings, reorganization and liquidation. It means that the aims of the insolvency framework are three: the protection of credit, business and employment.

The Colombian Constitutional Court, regarding the aims of the insolvency framework and its structure, in decision C-1143 of 2000, stated the following:

> "In general, insolvency proceedings are oriented towards the protection of the business' organization and, through it, towards maintaining employment and safeguarding the credit system. This triple objective is achieved by subjecting companies that face economic crises to certain procedures, which can be of two kinds: a) concordat, or agreement to recover the debtor's business, and b) mandatory liquidation, or realization of the debtor's assets to meet the orderly payment of its obligations."[70]

Those three aims are designed to be reached through both insolvency proceedings, reorganization and liquidation, based upon a list of principles (article 4 Law 1116), among which can be found universality, equality and efficiency, which for the author are the three most relevant ones for this study.

Universality is comprehended in its both faces, objective and subjective. Objective universality refers to the comprising of all the assets of the insolvent debtor, as a derivation of the "common pledge" of the creditors. On the other hand, subjective universality refers to the

[70] Corte Constitucional, Sentencia C-1143 de 2000

collectivity or plenitude by virtue of which all creditors are linked to the insolvency process, be it reorganization or liquidation.

This means that, if the insolvency proceeding involves all the debtor's debts or liabilities (all creditors), in the same way all the debtor's assets are affected as well in order to face its liabilities. In other words, since the process involves all the debtor's creditors, who lose the right to individually execute their debts (*ut supra* Stay of individual enforcement actions), in return all the debtor's assets will be available to fulfill those obligations.

The principle known as *par conditio omnium creditorum* or "equality", is laid down in the law in order to make sure that all creditors are treated equally during the insolvency proceeding, ancillary to the type of credit and creditor. This principle literally means "parity of treatment under equal conditions", which purpose is to ensure the proportional satisfaction of creditors' rights, while at the same time respecting their preferential position under the law[71]; e.g. secured creditors are treated equally among them, but are treated differentially in comparison to the treatment given to unsecured creditors.

According to the Latin expression *pari passu*, the universality principle states that all creditors of similar rank or condition must be satisfied in proportion to the amount of their credit, charged to the available debtor's assets (which are the common pledge of the creditors). Consequently, all creditors bear to the same degree and intensity the loss caused by the insolvency of the debtor.[72]

[71] Wolters Kluwer, 'Legal guides' (Wolters Kluwer, Online dictionnary) [Guias jurídicas] < https://guiasjuridicas.wolterskluwer.es/Content/Documento.aspx?params=H4sIAAAAAAAAEAMtMSbF1jTAAAUNjUwMLtbLUouLM_DxbIwMDCwNziEBmWqVLfnJIZUGqbVpiTnEqAOYsQys1AAAAWKE> accessed 23 May 2021

[72] Juan Jose Rodriguez Espitia, Nuevo Regimen de Insolvencia (2nd edn, Universidad Externado de Colombia 2019) 126-127

It is important to clarify that the application and validity of these two principles was hindered by the introduction of Law 1676 of 2013 by which a new movable securities regime was implemented, inspired upon the Organization of American States (OAS) InterAmerican Model Law of movable securities[73], and it takes a similar approach to the UNCITRAL Model Law on Secured Transactions[74].

By these movable securities, the universality principle (objective and subjective) is challenged because a secured creditor has the possibility to execute its security outside the insolvency proceeding; by which, among other things, the equality principle is also challenged, because that specific secured creditor is treated differently in comparison to other creditors of the same category (secured creditors).[75]

By last, the efficiency principle aims for optimizing the resources that make up the debtor's assets to make them the most profitable as possible for the creditors' benefit. Insolvency is to be addressed and resolved in a fast, orderly and efficient manner, in order not to cause undue disruption to the development of the business (in case of a reorganization or restructuring proceeding), or to obtain the maximum value of the assets (regarding a mandatory judicial liquidation).[76]

[73] Organization of American States, 'InterAmerican Model Law of Movable Securities' (2002) CIDIP-VI/RES.5/02. Acta final, OEA/Ser.C/VI.21.6, 2002
[74] UNCITRAL, 'UNCITRAL Model Law on Secured Transactions (2016) - Status' (United Nations Commission On International Trade Law) <https://uncitral.un.org/en/texts/securityinterests/modellaw/secured_transactions/status> accessed 12 May 2021
[75] For further reading: Camila Andrea Rincon Bohorquez, 'Law of Security Rights over Movables: Security Interests on Insolvency Processes. A Look from Insolvency Law Principles and Credit Priority' (2019) 18 Rev E-Mercatoria 209.
[76] Juan Jose Rodriguez Espitia, Nuevo Regimen de Insolvencia (2nd edn, Universidad Externado de Colombia 2019) 129

As a conclusion, and citing the Superintendency of Corporations, the abovementioned three principles can be defined as follows:

> "1.- Universality: All the debtor's assets and all his creditors are linked to the insolvency process from its initiation.
>
> 2.- Equality: par conditio creditorum. Equitable treatment of all creditors who attend the insolvency process, without prejudice to the application of the rules on priority of credits and preferences.
>
> 3.- Efficiency: Use of existing resources and the best management of them, based on available information."[77]

2. Out-of-court insolvency proceedings

Before analyzing the two regulated proceedings available for companies in economic distress (*ut infra* In-court insolvency proceedings), judicial reorganization and liquidation (which implies *per se* the winding up of the company), it is important to clarify that the Colombian insolvency framework also provides debtor with the possibility of privately renegotiate its debts. Such private or out-of-court reorganization proceeding can be found in article 84 of Law 1116, which provides for a so called "judicial validation of extra-judicial reorganization agreements".

This out-of-court reorganization proceeding is a completely new figure[78] that was introduced by Law 1116 to the Colombian legal regime, where the negotiations are carried out

[77] Superintendency of Corporations, Aene Consultoria SA (2009) Decision 405-006353 of March 31, 2009
[78] An initial study and analysis of the figure can be found in DianaLucia Talero castro and Rafael Wilches duran, 'Judical Validation of Private Restructuring Agreements An Example of 'Privatization' of the Insolvency Law in Colombia' [2010] 120(1) Vniversitas 271

in a private way with no judicial intervention, which primarily aims to prevent the insolvency of the debtor, or for it to be attended in an efficient and effective way before it is too late.

According to the cited recital, the validation of private reorganization agreements is as follows:

> "When outside of the reorganization process, with the consent of the debtor, a plural number of creditors equivalent to the majority required in this law to enter into a reorganization agreement, enter into an agreement of this nature, any of the parties to said agreement may request the bankruptcy judge that has been competent to process the reorganization process, the opening of a validation process of the out-of-court reorganization agreement entered into, in order to verify that it: (…)".[79]

At the time of the implementation of this regime, the figure was so attractive and innovative regarding the traditional insolvency proceedings that had existed since a long time before in the Colombian legal framework. This figure was initially designed in a way where the debtor with a plural number of creditors is called to negotiate a reorganization agreement, which needs to comply with some requirements in order to be binding and considered to have the same effects as a judicial reorganization agreement.

According to article 84, this private reorganization agreement needs to comply with the following:

[79] Ley 1116 de 2006 art 84

"1. It has the [majority of votes needed] percentages [in each class of creditors] required in this law [for judicial reorganization proceedings].

2. The negotiations have been sufficiently public and open to all creditors.

3. It grants the same rights to all creditors of the same class.

4. It does not include illegal or abusive clauses, and

5. In general terms, it complies with the legal precepts."

As it can be easily appreciated, the requirements that the judge needs to check *prima facie,* before validating the out-of-court reorganization agreement are too broad and in general, require to meet the requisites of an in-court restructuring agreement. Such difficulty was addressed by the legislator, which by the Decree 991 of 2018, issued a more detailed regulation of the figure.

As the baseline, the debtor cannot be currently involved in an insolvency proceeding (reorganization or liquidation process), otherwise the possibility of privately start negotiations with the creditors (all or some of them) is prohibited by law. It is important to clarify that, even though for the validity of this agreement there is no need for the involvement of all creditors, all of them have to be informed of the beginning or at least existence of the negotiations and therefore be allowed to participate on those.

Another characteristic of this figure is that, in order to start these private negotiations and to successfully subscribe an out-of-court agreement, there is needed the consent of both, a plural number of external creditors (complying with the majorities to successfully subscribe judicial reorganization agreements) and the debtor. The law nor the regulation establish at what point of time it is considered that the negotiations have begun and therefore there is

no legal consequence, however as it was mentioned above, all creditors are to be informed of the start or at least about the existence of the negotiations.

Third, either of the parties (debtor or creditors) may ask the insolvency judge to authorize the agreement, and once such procedure is met, it would have the same effects as a judicial reorganization agreement. The importance about the request of validation of the out-of-court reorganization agreement is that at that point of time all the consequences of the beginning of a reorganization proceeding come to effect (Law 1116 of 2006, article 17).

This out-of-court reorganization agreement is technically a contract by which the parties, the debtor and his creditors (meeting the majorities required by law), dispose of the terms and conditions in which the obligations under their charge will be met. Its contractual nature gains more strength if it is considered that it is not celebrated in a judicial setting. However, as some of the most known scholars in the matter have noted[80], such contractual nature of the agreement has been denatured by the extensive regulation provided by Decree 991.

In spite of the importance of including proceedings inviting debtors to face difficulties before insolvency becomes an issue, this out-of-court reorganization agreements have not been well received or very much implemented by debtors and creditors. As data shows, between January and September 2020, there were just 12 requests of validation of out-of-court reorganization agreements, while there were over 374 in-court restructuring proceedings filed in that same time period.[81]

[80] Juan Jose Rodriguez Espitia, Nuevo Regimen de Insolvencia (2nd edn, Universidad Externado de Colombia 2019) 1120

[81] Superintendencia de Sociedades, 'Atlas de Insolvencia – Insolvencia en Colombia: Datos y Cifras' (Superintendencia de Sociedades, February 9, 2021) <https://www.supersociedades.gov.co/delegatura_insolvencia/Documents/2021/ATLAS-INSOLVENCIA-CORTE-DIC-2020.pdf> accessed 12 May 2021

3. In-court insolvency proceedings

In the Colombian insolvency legal framework, there are two regulated insolvency proceedings. On one hand, reorganization proceedings are aimed to, through a reorganization agreement, "preserve viable companies and normalize their commercial and credit relationships, through their operational, administrative, asset or liability restructuring"[82]. On the other hand, liquidation proceedings, are left to debtors which are no longer economically viable, focusing on a prompt and orderly liquidation, seeking to maximize the break-up value of the debtor's assets.

Regarding the mandatory liquidation proceedings, the Colombian Constitutional Court stated that it "pursues the prompt and orderly liquidation, seeking to take advantage of the debtor's assets"[83]. Vis-à-vis the reorganization or restructuring proceeding, the same Court established the following:

> "The figure of the concordat allows companies with serious difficulties in the payment of their liabilities, to reach an agreement with their creditors, in order to allow their recovery and conservation, as economic exploitation units and employment sources, and also by protecting the credit ... while drawing up the rules to which the fulfillment of the unresolved obligations under its charge is submitted."[84]

[82] Ley 1116 de 2006 art 1
[83] Corte Constitucional, Sentencia C-620 de 2012
[84] Corte Constitucional, Sentencia C-1143 de 2000

According to the law, to be admitted to a reorganization or restructuring proceeding, a debtor must be in cessation of payments or on impending insolvency (impending inability to pay its debts). On the other hand, according to article 49 of Law 1116, judicial liquidation of a business or company is available, among others, by the debtor's express request or by the breach of a reorganization agreement; however, the beginning of a judicial liquidation proceeding supposes the existence of a situation of cessation of payments, as required for the commencement of a reorganization proceeding.

4. Reorganization proceedings: "Pre-insolvency" under Law 1116 of 2006

There are two general requirements for commencing reorganization proceedings in Colombia, according to the Corporate Insolvency Regime. As it was briefly mentioned above (*ut supra* What is "insolvency"?), cessation of payments is one of those requirements, and is understood as when the debtor fails to pay for more than ninety days, two or more obligations in favor of two or more creditors, or has at least two execution proceedings filed by two or more creditors for the payment of obligations. However, in any case, the accumulated value of the unpaid liabilities must represent at least ten percent (10%) of the total liability of the debtor.[85]

The other requirement is understood as a situation of '**impending insolvency**' of the debtor, which is defined as follows:

> "2. Imminent inability to pay. the debtor will be in a situation of imminent inability to pay, when he proves the existence of circumstances in the respective market or

[85] Ley 1116 de 2006 art 9

within its organization or structure, which affect or can reasonably affect in a serious way, the normal fulfillment of its obligations with a due date equal to or less than one year"[86].

As the law provided, a debtor can be involved in a reorganization proceeding not just in case of cessation of payments (actual insolvency), but when it is imminent that it will become insolvent (*pre-insolvency*).

It is the debtor who is called to analyze and establish whether it is *ad portas* to be in an insolvent state. The circumstances that are considered to drive the debtor to that state are to be proven by him and verified by the judge; circumstances that need to be serious enough to compromise the future viability of the debtor, and not just a possible but not probable event.

Among the possible circumstances under which a debtor may be in order to be facing an "impending insolvency", are those cases in which it must make payments of long-term obligations and is able to foresee that, given the market conditions, he will not be able to fulfill them. Also, in cases on which the debtor is facing a lawsuit for damages, with respect to which he can prove that will not be able to oppose successfully to the claims and therefore will not be able to pay a given amount of money in case it is found to be liable.

Under this commencement requirement, judges are called to be very cautious when analyzing the debtor's exposure to the alleged impending insolvency, which must be adequately

[86] Ley 1116 de 2006 art 9

supported and proved, considering the actual existence of circumstances that would seriously affect the company's viability.

Regarding this topic, the Superintendence of Corporations, which is the national authority with competence to hear this kind of proceedings, has been very cautious – and sometimes stricter than expected – while revising the compliance of the requisites of debtors to commence an insolvency proceeding under this requirement. After having revised decisions of admission to reorganization proceedings between 2017 and 2020[87], it could be found that in most of the cases, showing a negative cash-flow within the following year was indispensable for a debtor to be admitted to this kind of proceeding.

In decisions identified with numbers 400-011004, 400-012536, 400-014487, debtors were admitted to reorganization proceedings by showing with a projected cash flow that the income obtained and projected would not be sufficient to cover all the liabilities due in the periodicity agreed with the creditors. While in decisions 400-005940, 400-006705, 400-010876, among others[88], the debtor complemented its request of admission by showing how market difficulties and changes would make it impossible for them to fulfill their obligations.

As an example, the behavior of the market of massive public transport in Colombia during 2017 was not as it was initially expected. For that reason, debtors such as Tanzil S.A.S.,

[87] More than 40 decisions between years 2017 and 2020 were revised. The most relevant and clear ones are to be summarized.

[88] Superintendency of Corporations, Compañía General de Aceros SA (2017) Decision 400-001122 of January 26, 2018, Superintendency of Corporations, Agregados el Rodeo SAS (2017) Decision 400-001220 of January 30, 2018, Superintendency of Corporations, Arquitectos e Ingenieros Asociados SA (2017) Decision 400-016083 of November 7, 2017, Superintendency of Corporations, Grupo Integrado de Transporte Masivo SA (2017) Decision 400-018324 of December 21, 2017, Superintendency of Corporations, Manufacturas de Cemento SA (2017) Decision 400-015744 of December 17, 2018

Masivo Capital S.A.S., Grupo Integrado de Transporte Masivo S.A., among others, requested the admission to reorganization proceedings. As it was argued by Tranzit S.A.S. on its application, its main economic activity was to provide public passenger transport service for which a concession contract was signed with a public entity. Given the market conditions of public passenger transport service in Bogota, and the unequal competence conditions with other market actors, it was going to be impossible for the company to fulfill its liabilities, which was shown with a projected cash flow for the next year. At the same time, Masivo Capital S.A.S. stated that an issue that contributed to its impending insolvency was a tariff deficit that led the system operators to work at a loss, issue that would not have a definitive solution in the short term.

Provided the above and following the same argument (projected cash flow deficit and market conditions as the circumstances needed to be proven in order to be admitted to a reorganization proceeding under the impending insolvency cause), in decisions 400-009257, 400-017714 and 400-017715, debtors were not admitted to the proceeding. Those are the cases of Danny Venta Directa S.A., Marketcol S.A. and Inversiones Suarez Cortes y Compañía S. en C.

In the case of Marketcol S.A., the Superintendency of Companies affirmed that in the projected cash flow presented by the debtor, there was no deficit shown. In the same fashion, while analyzing the application of Inversiones Suarez Cortes y Compañía S. en C., the Court affirmed that the debtor did not provide the required projected cash flow, which means that it was not possible to verify the existence and value of the liabilities that would be unfulfilled within the specified period by the law. By last, while analyzing the request of Danny Venta Directa S.A., the insolvency judge found out the following:

> "The projected cash flow indicates that from May 2017 to February 2018 the company will obtain a surplus, which means that it will be able to comply with the obligations acquired in the normal development of its activities. On the other hand, it is not clear which are the reasons that will not allow the debtor to meet the obligations originated before the submission of the application".

Unlike the previous decisions, there were debtors that were admitted to reorganization proceedings by showing that it was very likely for them to become liable to huge amounts of money, as they were joint debtors or personal guarantors of other debtors in financial distress. That is the case of companies such as OPT S.A., Puerto de Mamonal S.A. and Muelles de Mamonal S.A., which are a group of companies dedicated to cargo operations in harbors or seaports.[89]

On one hand, in the application for admission of OPT S.A. and Puerto de Mamonal S.A., the debtors showed a negative cash flow balance for the next year (2017-2018). Between February and December 2017, the debtors required a liquidity of $32,717 million (COP) to meet the agreements reached with financial entities, which generated a global cash default for the companies at the end of the year of more than $18 billion (COP) without addressing another investments and debts with distributors and other creditors.

[89] Document 2017-01-344336 presented by the legal attorney of Puerto de Mamonal S.A., in the proceeding identified with number 28821 (Puerto de Mamonal S.A.). Luis Hernando Gallo Medina, file for admission of Puerto de Mamonal S.A., (2017)

While, on the other hand, Muelles de Mamonal S.A. stated on its application that even though it had no overdue obligations, it is was joint debtor or guarantor of Puerto de Mamonal S.A. and OPT S.A., for financial obligations contracted by them with national and international financial entities. Such financial commitments would not be met under the conditions agreed by the guaranteed debtor companies, which constituted a contingent liability for Muelles de Mamonal S.A.

All three companies were admitted to a coordinated reorganization proceeding[90] under the commencement requirement of impending insolvency. For a similar line of decisions, it can be consulted the decisions regarding the admission to insolvency proceedings of Inversiones Coprim S.A.S., Colombiana de Sales y Minas Ltda. And Conversión de Sales y Concentrados S.A.

However, the "impending insolvency" entry requirement is not broadly used by debtors in distress in Colombia. In most of the cases, it is the cessation of payments the proven requirement by corporations or debtors in general in order to be admitted to a restructuring proceeding.

5. Reorganization proceedings: Characteristics

As it had been said previously, when a business is able to overcome financial difficulties, the direct consequence of that achievement is the preservation of jobs, maintaining supply

[90] Superintendency of Corporations, Puerto de Mamonal SA (2017) Decision 400-012011 of August 3, 2017

chains intact and retaining asset value.[91] The Colombian restructuring proceeding aims for reaching the businesses' recovery through a well-structured and effective procedure seeking to decrease the cost of credit by increasing the returns to creditors at the same time.

The reorganization proceeding was drafted in accordance with the goal of reaching the three objectives mentioned above (protection of credit, business and employment), inspired in the UNCITRAL Legislative Guide. As it was explained earlier (*ut supra,* Characteristics of Restructuring Frameworks), stay of individual enforcement actions, continuation of the business of the debtor and a reorganization plan are three main traits that were also included in the Colombian reorganization procedure.

a) Automatic stay

Being that these proceedings put in an equal footing both, debtor and creditors, it is important to not let out of sight that even though some exceptions apply, all possible actions against the debtor are grouped in a single proceeding, which is controlled by a single forum, preventing creditors to seize the debtor's assets.[92] This proceeding, in particular, is a fully collective one, meaning that, in principle, affects all creditors of a debtor, which implies that "individual rights enforcement of all creditors is restricted by the proceeding"[93].

[91] Antonia Menezes, 'Debt resolution and business exit: insolvency reform for credit, entrepreneurship, and growth' [2014] 1(1) View Point Public Policy for the Private Sector <https://documents1.worldbank.org/curated/en/912041468178733220/pdf/907590VIEWPOIN003430Debt0Resolution.pdf> accessed 8 February 2021
[92] Century Services Inc. v. Canada (A-G), 2010 SCC 60, [2010] 3 S.C.R. 379, para 22
[93] Horst Eidenmuller, 'What Is an Insolvency Proceeding' [2018] 92 Am Bankr LJ 53 66

This issue is addressed by the stay of individual enforcement actions, which is designed to prevent "a destructive uncoordinated race for the assets and facilitates a coordinated realization and distribution of the available value, thereby serving the interests of the creditors as a whole"[94]. This figure[95] is regulated in detail by article 20 of Law 1116 of 2006, which establishes the following:

> "Article 20. As of the start date of the reorganization process, no lawsuit for enforcement or any other collection process against the debtor may be admitted or continued".

In this legal context, the insolvency court is required to decide as to the commencement of the reorganization proceedings, which establishes that "the reorganization proceeding begins on the day of issuance of the order to initiate the process by the bankruptcy judge" (article 18), who, according to the time frames set out by the law, shall decide within three days after submitting the application (article 14).

This means that, once the debtor or a plural number of creditors (article 11), has filed the application to be admitted to a reorganization proceeding complying with the legal requirements, the judge must admit it within three days. Once admitted, it is understood that the reorganization proceeding has started and, because of that, creditors are not allowed to enforce their rights or securities against the debtor or its assets individually; the existing actions are suspended and there is also a moratorium on the commencement of new ones.

[94] Nicolaes Tollenaar, Pre-Insolvency Proceedings: A Normative Foundation and Framework (Oxford University Press 2019) 195.
[95] Parts of the doctrine criticize the automatic stay on insolvency proceedings. In particular: Nicolaes Tollenaar, "A statutory stay is not a structural solution and must not be regarded or used as such. It is only a temporary measure to facilitate the realization of a structural solution." In: Nicolaes Tollenaar, Pre-Insolvency Proceedings: A Normative Foundation and Framework (Oxford University Press 2019)

This stay of individual enforcement actions lasts until the end of the proceeding, either because there was a successfully negotiated reorganization agreement, or because the negotiations failed, and the debtor's business enters then to a liquidation phase.

Another consequence of the commencement of the reorganization proceeding is the preservation of contracts or, as the law calls it, "continuity of contracts". Since the aim of this kind of insolvency proceeding is to preserve the debtor's business and reorganize the enterprise or business so that it can be viable and profitable, it is a core issue for the debtor to preserve and continue performing important contracts, and at the same time to be able to terminate onerous ones.

Regarding the above, article 21 establishes the prohibition of terminating contracts due to the initiation of the reorganization process, and at the same time opens the door for the negotiation of the terms of onerous contracts and, when such thing becomes impossible, under specific circumstances, allows the debtor to reject such burdensome contracts.[96]

b) Debtor in possession

Since the main goal of reorganization proceedings is to preserve and continue the debtor's economic activity, the continuation of its business is another consequence of the commencement of the proceeding. As it was noted before (*ut supra* Continuation of the business

[96] For further reading about the preservation of valuable contracts and the rejection of burdensome ones, read Nicolaes Tollenaar, Pre-Insolvency Proceedings: A Normative Foundation and Framework (Oxford University Press 2019) 197

of the debtor), the continuation of the debtor's business does not imply *per se* the involvement of the debtor on its business; the role of the debtor during the reorganization proceeding is to be established by the law.

As how originally the restructuring proceeding was established by Law 1116, the debtor was displaced in all cases and the Court, with the initiation of the proceedings, had to appoint an IP (insolvency professional) representative, called "promoter". The IP was appointed from a previously approved list by the Superintendency of Corporations (article 62), and its duties were to take care of and continue pursuing the debtor's business and at the same time handle and direct the reorganization proceeding.

However, this rule was changed by Law 1429 of 2010, by which it was established that the debtor is to remain in control of the business, and at the same time, would handle the duties of a promoter or IP representative. According to article 35 of Law 1429 of 2010, under exceptional circumstances, the Court may appoint an IP while separating the debtor from conducting its business, attending to strict criteria such as the importance of the company, the amount of its liabilities, the number of creditors, international nature of the operation, among other conditions.

c) Reorganization agreement

As a matter of fact, the final goal of a reorganization proceeding is reorganizing the debtor's business in order to rescue it from liquidation, and the way its achieved is by negotiating a reorganization agreement. According to the Colombian insolvency framework, the debtor must attach with the application of commencement, a proposal for a reorganization plan

(article 13.6), and if he is not the one who files the application, still will be required to present one (article 14).

After an inventory of creditors, liabilities and voting rights has been approved by the Court, the designated IP or the debtor itself (if no IP was appointed), has a term of four months in order to present the Court a duly approved reorganization agreement (according to the voting rules and majority rules provided by the law), based on the reorganization plan of the company initially provided, and the projected cash flow to meet the payment of past and future obligations.

When the agreement has been submitted by the debtor, the Court will call for a hearing to confirm the agreement. The hearing's purpose is so that creditors can present their observations tending to the Judge to verify its legality. If the judge denies the confirmation, the hearing will be suspended, so that the agreement is corrected and approved by the creditors. In case the agreement is not corrected or approved by the required majorities, the Court will declare finalized the reorganization or restructuring proceedings, and a liquidation proceeding is to be started.[97]

By last, a reorganization agreement has effects over dissenting and absent parties. It means that, according to article 40 of Law 1116 of 2006, a confirmed reorganization agreement shall be binding on the respective debtor or debtors and on all creditors, including those who have not participated in the negotiation of the agreement or who, having done so, have not consented to it.

[97] Ley 1116 de 2006 art 35

d) Duration of insolvency proceedings in Colombia

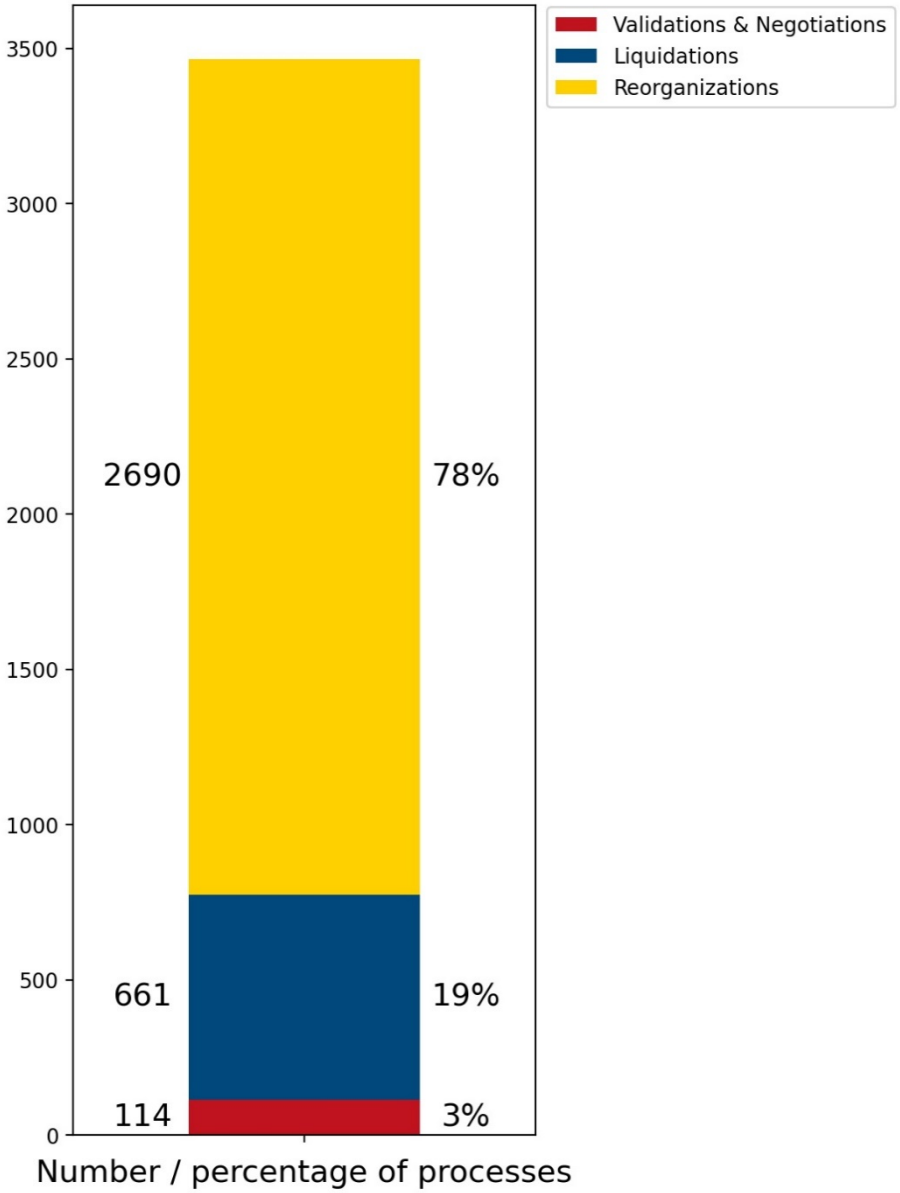
Efficiency, as one of the principles that serve as guidelines for directing the proceedings, and as one of the objectives of the law, as it was previously mentioned, the Colombian insolvency framework includes time limits for the court, debtor, and insolvency practitioner. However, exceeding those time frames in most of the cases does not influence the validity of the actions or the competence of the Court or insolvency judge in each case.

Reorganization proceedings can be divided in two phases. The first one starts with the filing of application and ends with the Court's decision approving an inventory of creditors, liabilities and voting rights (credit rating decision); while the second phase comprises, the time frame the promoter has to present the Court a reorganization plan duly approved by the creditors and ends with its confirmation or denial by the judge. According to the Insolvency Framework, the Court has three business days to decide whether to admit or reject an insolvency application; and the promoter or appointed IP has four months to present the Court an approved reorganization plan by the creditors, among other deadlines.

However, the time limits mentioned above are very unlikely to be met, and very often are not obeyed. Sometimes, such deadlines set forth in the law are impossible to follow, regarding the workloads of the legal system, staff shortages and overall, the organization of the Superintendence of Corporations, which leads the most insolvency proceedings among the country.[98]

[98] For a European overview, read Kruczalak-Jankowska Joanna and others, 'The relation between duration of insolvency proceedings and their efficiency (with a particular emphasis on Polish experiences)' [2020] 29(1) International Insolvency Review <https://doi. org/10.1002/iir.1392> accessed 5 May 2021

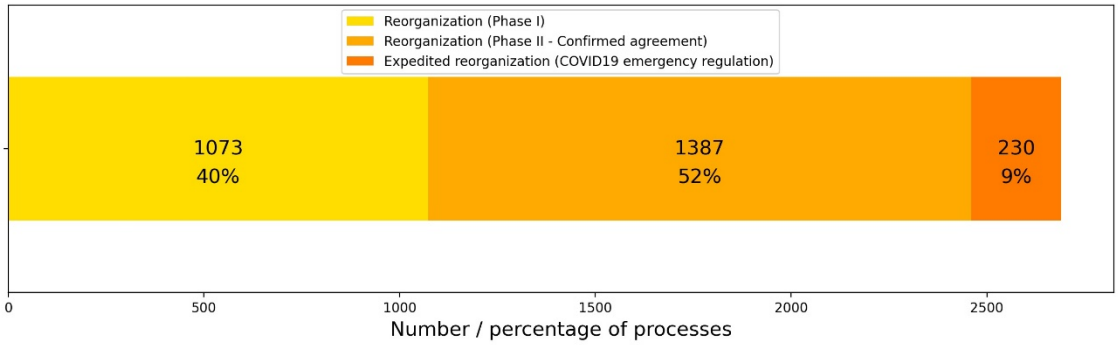
As data[99] shows, as of December 31st of 2020, the Superintendency of Corporations (the Court) was carrying out a total of 3,465 **insolvency proceedings** (Chart 1).



(Chart 1: 3462 cases – classification)

[99] Database including information of current insolvency proceedings under the Superintendency of Corporations' competence as of December 2020. Can be found in: Superintendencia de sociedades, 'Datos & Cifras' (Procedimientos de Insolvencia, January 2021) <https://www.supersociedades.gov.co/delegatura_insolvencia/Paginas/publicaciones.aspx> accessed 12 May 2021

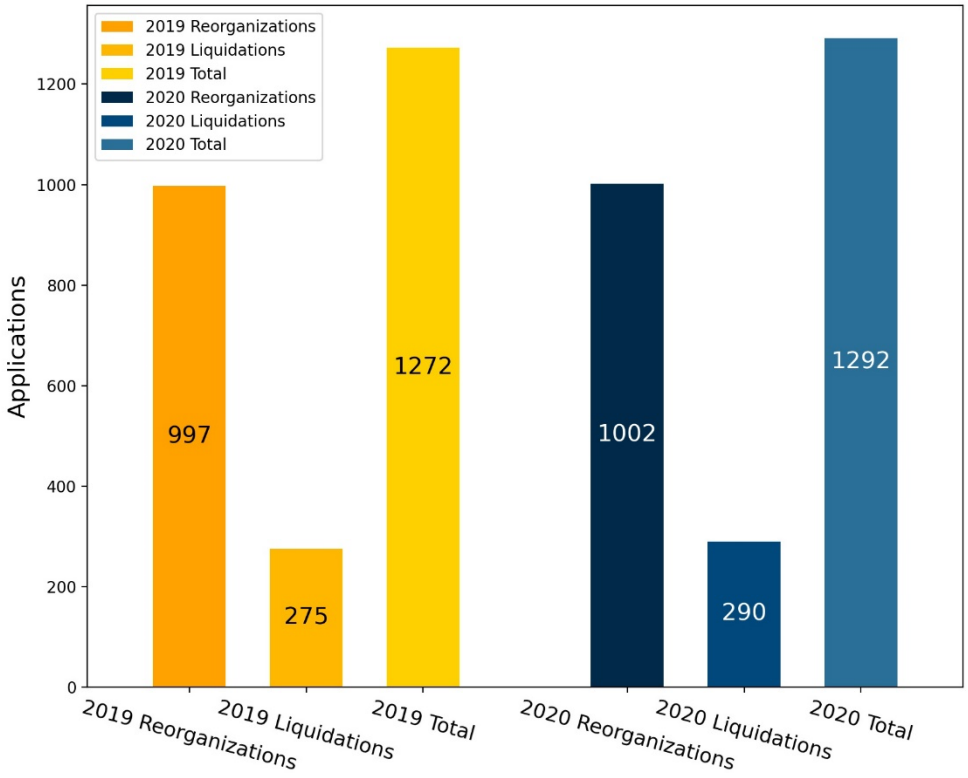
From those, more than the 77% of them corresponded to **reorganization proceedings**, between proceedings that were under the negotiation phase (so called "Phase I") and reorganization agreements that were confirmed and already under execution ("Phase II") (Chart 2).



(Chart 2: 2690 reorganization – classification)

Between 2004 and 2020 there was a rise of 124% of **filed applications** (including both, reorganization, and liquidation applications) among the country; and between 2019 and 2020 only there was a rise of 2%[100] (Chart 3).

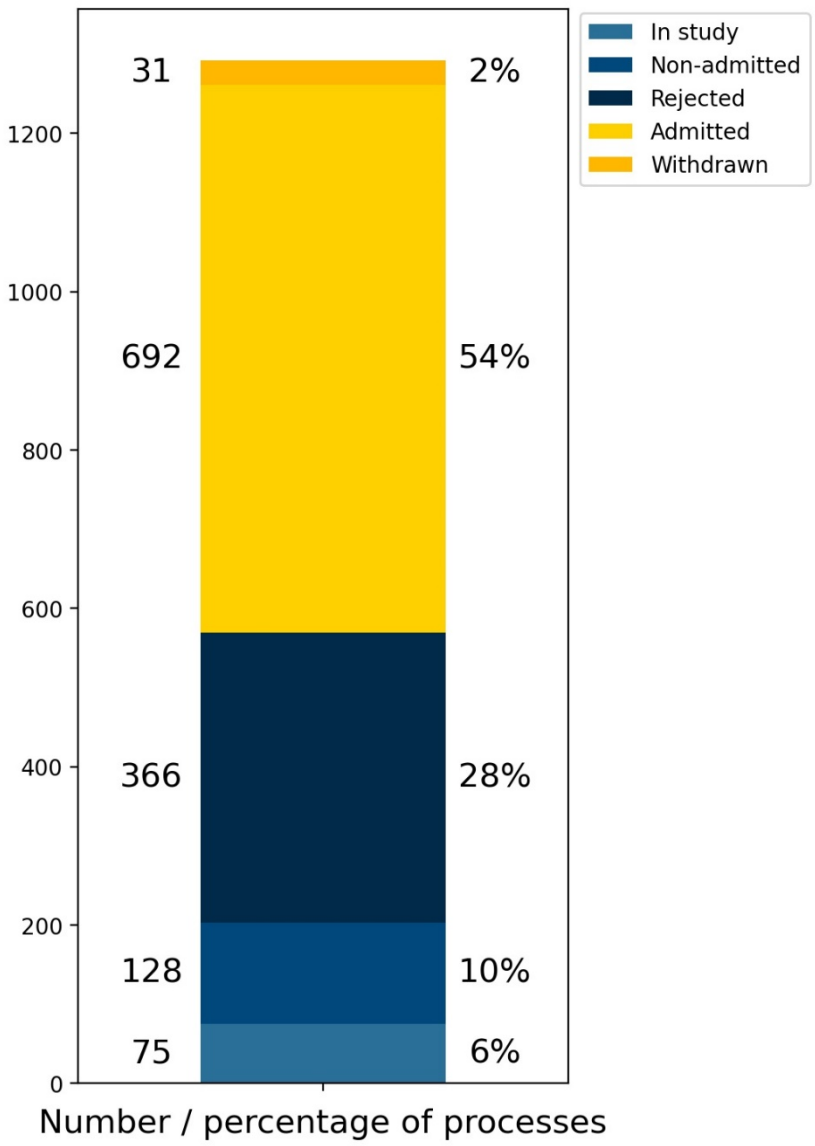
[100] Superintendencia de sociedades, 'Atlas de Insolvencia – Insolvencia en Colombia: Datos y Cifras' (Superintendencia de Sociedades, February 9, 2021) <https://www.supersociedades.gov.co/delegatura_insolvencia/Documents/2021/ATLAS-INSOLVENCIA-CORTE-DIC-2020.pdf> accessed 12 May 2021



(Chart 3: Graphic comparing applications filed between 2019 and 2020)

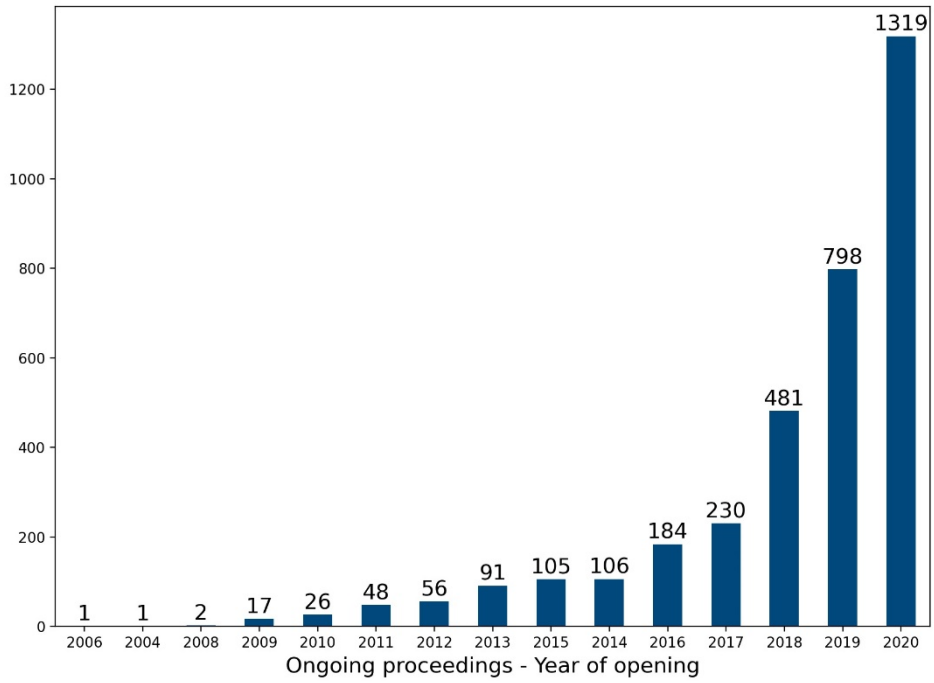
According to the data provided by the Superintendency of Corporations, only in 2020, there were 1292 **applications** to insolvency proceedings, from which almost 700 were admitted, and about more than 300 were rejected, as it is shown in the following graph (Chart 4). Only between January and December of 2020, there were 1,074 new reorganization proceedings, but only 480 proceedings of this kind were finalized[101].

[101] Superintendencia de sociedades, 'Atlas de Insolvencia – Insolvencia en Colombia: Datos y Cifras' (Superintendencia de Sociedades, February 9, 2021) <https://www.supersociedades.gov.co/delegatura_insolvencia/Documents/2021/ATLAS-INSOLVENCIA-CORTE-DIC-2020.pdf> accessed 12 May 2021



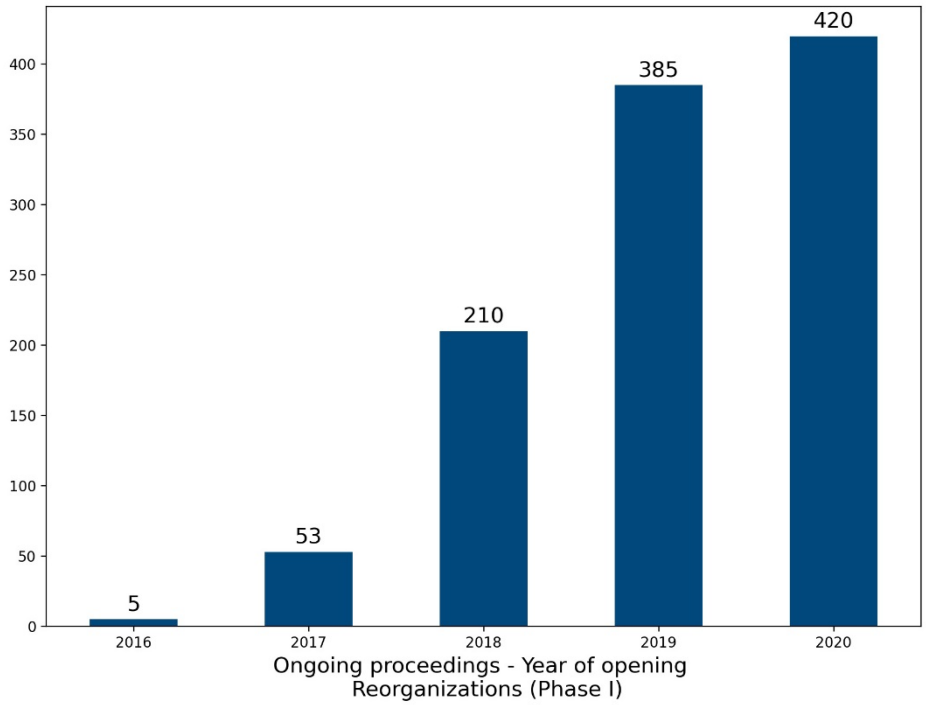
(Chart 4: 1.292 applications in 2020 – Progress)

Regarding the data under analysis, the single most striking observation to emerge from it is the time or **duration** of a single insolvency proceeding. As it is shown below (Chart 5), the data suggests that there are proceedings in course since 2004 (liquidation proceedings), and reorganization ones without a reorganization plan approved by the Court from 2016 until 2020.



(Chart 5: Ongoing proceedings. Liquidation and Reorganization - Starting date)

The previous chart is interesting in several ways. First, it shows how much more reorganization proceedings are ongoing currently in comparison to liquidation ones. Second, it illustrates how long an insolvency proceeding can take in Colombia. We observe from Chart 6 in detail that among the 1073 reorganization proceedings without a reorganization plan, there are still five ongoing that were opened in 2016, 53 that begun in 2017, still 210 that started in 2018, and 385 from 2019.



(Chart 6. Ongoing reorganization proceedings in detail, from 2016 until 2020)

The evidence from the analysis of the information provided by the Superintendency of Corporations implies that the deadlines or time frames given by the law are in most cases not obeyed at all. These long-term insolvency proceedings slow down the recovery rates of businesses and, by the same reason, end up being more costly than initially planned.

Taken together, these results suggest that the Colombian insolvency framework hardly provides for a timely, efficient, and impartial resolution for insolvencies, which means that it is failing to meet one of its main goals. These lengthy proceedings unduly disrupt business activities of both, the debtor, and its creditors, and unfortunately maximizes the cost of the proceedings.

V. Measures to increase the efficiency of procedures: Guidelines and recommendations to be studied

As stated in the previous chapter, even though there is a reorganization insolvency framework in Colombia, aiming for businesses and debtors to restructure their liabilities before it is too late and business' liquidation becomes unavoidable, it is not an efficient framework and hardly provides for a timely resolution for financial difficulties (Chart 6).

The European Union approach to insolvency and the newly designed pre-insolvency restructuring framework is an innovative alternative that should be considered by the Colombian authorities and legislator to provide an actual relief to the judicial system on one hand, and to debtors in financial difficulties with real possibilities to recover from a possible insolvent situation.

This new kind of proceedings tend to make the reorganization of debts less costly and more effective, to rehabilitate the enterprise. Even though there already exists a private reorganization proceeding in the Colombian legislation, as it was also shown (*ut supra*) it is not broadly used by creditors, which could be because of the private traits of the figure.

The proposed formula here would be to implement or adapt a formal negotiating procedure, which should end with a reorganization enforceable agreement with the debtor's principal creditors, under the characteristics that are going to be discussed below.

1. Early warning tools

Early warning tools are a mechanism introduced in the Directive to help debtors in financial distress to notice when business is not going out as planned. Anyone knows better its own business than the debtor itself, however laying down some tools to provide the debtor to be aware of circumstances that might be impacting its own business so that insolvency can be avoided is a huge advantage for the market itself.

As it was mentioned above, the proposed system by the EU Directive includes internal and external monitoring to ensure effectiveness, "which take the form of alert mechanisms that indicate when the debtor has not made certain types of payments could be triggered by, for example, non-payment of taxes or social security contributions"[102]. Also, incentives to third parties to flag the debtor in case of "bad [financial] development" are encouraged not to impose any liability *per se* to debtors but to incentivize them to take early action.

2. "Likelihood of insolvency" and "impending insolvency"

The availability to access to this kind of proceedings, is indeed to be in a likelihood of insolvency, but not yet insolvent. One of the requirements for commencing reorganization proceedings laid down in Law 1116 of 2006, "impending insolvency", can be adapted and analyzed in a not so strict way to let debtors get into to a pre-insolvency state of business to be allowed to negotiate their debts.

[102] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency) [2019] OJ L172/26 para 22

It is important not to forget that the existence of these proceedings is justified only in case of a likelihood of insolvency of the debtor, in contrast with the availability of other restructuring proceedings in other parts of the world, such as Chapter 11 in the United States.

A viability test may be based on a cash-flow analysis as it is already existing under Law 1116 but extending the evaluation from a 12-month period to a 24-month one or, even longer. Adapting an approach such as the one settled by the German legislators could be a good guideline to establish the accessibility to this new alternative pre-insolvency proceeding.

3. Limit the effects of commencing proceedings

As the debtor is in a state of pre-insolvency and not in insolvency, the effects of this kind of proceedings should not be as radical and strict as the effects of commencing restructuring proceedings under Law 1116 of 2006. The commencement is voluntary for the debtor or its directors, and it should not be mandatory for every creditor to be involved on it. However, notification to all affected parties should be one of the conditions for confirmation of a restructuring plan.

As Directive 2019/1023 regulated, commencement of negotiations does not involve an authority's (administrative authority or Court) decision, unless strictly necessary. It necessarily means that an automatic stay cannot be granted by law and therefore a formal decision of commencement of proceedings is not needed.

Since not all creditors are forced to be involved in the negotiation of their debts, as an aim to make it easier for the debtor to negotiate with its most important creditors, the proceeding could stablish a particular kind or categories of creditors who should be forced to be called to negotiate these kinds of agreements.

Another way of addressing the unwillingness of some creditors to negotiate with the debtor could be designing a stay of individual enforcement actions can be granted, if by request of the debtor. Such stay can be general or applicable only to individual creditors or categories of creditors; however, always analyzed by the insolvency authority case by case, evaluating the economic situation of the debtor, the kind of claims and size, and the impact of an enforcement action regarding a particular creditor or category of creditors.

Taken together, limiting the involvement of the judge to situations where it is necessary and proportionate to protect rights and interests of debtors and other affected parties, a non-automatic stay of individual enforcement actions, granted case by case if requested by the debtor, which can be general to all kinds of creditors or particular, depending on the underlying situation, are two effects of commencing this kind of pre-insolvency proceeding that could be adapted and adopted in the Colombian legislation.

By last, measures such as the “continuity of contracts” or the inapplicability of ipso facto clauses that provoke an early termination of contracts, should apply in order to protect the negotiations and provide for more incentives for the debtor to address the problem of likelihood of insolvency in a more efficient way.

4. Debtor-in-possession regime and appointment of an IP

Taking advantage of the framework designed by the EU Directive on pre-insolvency proceedings, another characteristic that could be adopted, which is not strange to the Colombian insolvency framework, is the debtor-in-possession regime with no need of the appointment of an insolvency professional.

Debtors should be left in control of the day-to-day operation of their business and assets, and should be left to direct the negotiation of their debts. However, under strict circumstances, appointing an insolvency practitioner could be useful, not as the figure of the "Promoter" of Law 1116 of 2006, but more as a supervisor of the activity of the debtor and as a leader or conciliator of differences during the negotiation of the debts.

5. Effects of a restructuring plan

As discussed above, the goal of a pre-insolvency or a restructuring proceeding is getting to reorganize the debtor's business to recue it from liquidation. Such goal is reached by negotiating a reorganization agreement.

In the case of the European pre-insolvency framework, the effects of restructuring plans are limited only to affected parties, which means that not necessarily all creditors are required to be involved, nor all debts or liabilities need to be restructured. In contrast with the European framework, Law 1116 does require all debtors and existing debts before the beginning of insolvency proceedings, to be included in the agreement, which ends to be binding to all parties, even absent or dissenting.

In this particular case, since not all creditors nor debts are to be affected nor included in the negotiation and reorganization agreement, the effects of a restructuring plan should be limited only to affected parties, which must have been involved in the adoption (negotiation and voting) of the plan. It would be left to the policy makers to decide which are the required majorities and if a cross-class cram down would be acceptable, however these issues fall outside the scope of this study.

VI. Tools to ensure the efficiency of preventive restructuring procedures

1. Mechanisms to be implemented by Member States

As it was found out by the European Commission, the excessive length of insolvency proceedings "is an important factor triggering low recovery rates and deterring investors from carrying out business in jurisdictions where procedures risk taking too long and being unduly costly". A good restructuring framework in paper does not necessarily mean that its going to provide satisfactory outcomes in practice and, for that reason, an adequate judicial infrastructure would help ensure the reach of such goal.[103]

As the 2016 Insolvency study showed, "inefficiency within public institutions, long delays in reaching decisions, high costs of administrative formalities, lengthy judicial proceedings"[104] (among others), were key factors to be improved to increase economic outcomes when it comes to do with insolvency regulatory regimes. For that, implementing this kind of pre-insolvency, out-of-court but with some court involvement may be key in improving the recovery rates and ways of dealing with financial difficulties for debtors and businesses.

The EU Directive 2019/1023, under Title IV, included some measures with the aim to increase the efficiency of this kind of proceedings. Between articles 25 to 28, there is a series of tools for Member States to implement in order to guarantee a satisfactory outcome of

[103] Commission, 'Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU' COM (2016) 723 final
[104] Judith Dahlgreen and others, Study on a new approach to business failure and insolvency Comparative legal analysis of the Member States' relevant provisions and practices (Publications Office of the European Union 2016) 118

proceedings and ensure the effectiveness of the new pre-insolvency framework. First, members of the judicial or administrative authorities dealing with this kind of procedures shall be suitably trained and have enough experience for the issues they are dealing with. Second, insolvency professionals must have the necessary expertise and high-quality training in order to fulfill their duties or obligations of an IP. By last, Member States should enable "practitioners and judicial and administrative authorities to use electronic means of communication"[105].

2. Existing tools in the Colombian legal framework to improve efficiency

In Colombia, the Superintendency of Corporations, had implemented electronic means of communication to perform different milestones of insolvency proceedings. In fact, in 2020 and facing the challenges the COVID-19 pandemic brought, it implemented a model governed by artificial intelligence to make it possible for debtors, creditors, insolvency professionals and all affected parties, to virtually access to documents, file claims and even to have online public hearings. As it is stated

> "[T]he digital transformation project being carried out by the Superintendency of Corporations is developed under the creation of AI and robotics models, in order to classify, predict and optimize structured and unstructured information in the mission processes of the Superintendency of Companies"[106].

[105] Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency) [2019] OJ L172/26 para 90.

[106] Superintendencia de Sociedades, ' Supersociedades recibió reconocimiento como "Entidad Pionera" en el uso de herramientas de Inteligencia Artificial en la Nube Pública' (Noticias, November 4, 2020) < Supersociedades recibió reconocimiento como "Entidad Pionera" en el uso de herramientas de Inteligencia Artificial en la Nube Pública> accessed 15 May 2021

Being one step ahead of the implementation of technology and even of artificial intelligence as a tool to improve the development of proceedings and to enhance its effectiveness, the introduction of a pre-insolvency framework with the characteristics described above would help the entity on transforming the way justice is being administered. By requiring more action from debtors to act in a prompter manner and, at the same time, providing them with incentives to recognize when a crisis is likely to happen, less claims would be filed, while more privately held negotiations would be happening, by having recourse to the judge in necessary situations, without congesting the institutional apparatus.

VII. Conclusions

Legal systems contain provisions regarding proceedings under insolvency law and governed by it which can be initiated to solve the economic circumstances of a debtor in financial distress. Reorganization and liquidation proceedings are most of the times included in these formal insolvency proceedings, for which insolvency is a requirement.

Most legal frameworks establish that the debtor must be in some important financial distress for an insolvency proceeding to be started. This "financial distress" most of the times means that the debtor is required to in an insolvent state, which can be defined as the impossibility for the debtor to pay its debts as they mature, or when its liabilities exceed the value of its assets. The former is called 'cash-flow insolvency', while the latter is the 'balance sheet insolvency'.

Restructuring proceedings are at the core of Insolvency law. These procedures are designed by legal frameworks with the aim of recovering the business or enterprise, when found viable, while seeking for the best of interests of all parties, debtor and creditor, and the business per se. Restructuring proceedings designed by traditional insolvency frameworks include some remarked characteristics, which were grouped in this paper in three: Stay of individual enforcement actions, continuation of the business of the debtor (most of the times implying a debtor-in-possession model) and the existence of a restructuring plan.

In contrast to the traditional approach of insolvency, there has been growing interest among regulators and legislators in providing another kind of solutions, trying to prevent debtors to become insolvent to seek for aid or restructuring. Such is the case of legislations that

made insolvency proceedings available to debtors that, even though are not in financial distress yet, might become insolvent in the future if measures are not taken. Such frameworks include pre-insolvency as a possible admission to insolvency proceedings.

The Colombian Insolvency Regulation (CIR) undertook a traditional approach of how to address collective satisfaction of debts regarding financially distressed debtors, by establishing a restructuring proceeding which is ought to involve all the debtor's debts or liabilities (all creditors), and all the debtor's assets. This proceeding also comprises an automatic stay for individual enforcement actions, continuation of the business of the debtor, implying in most of the cases a debtor-in-possession proceeding and the need to approve a reorganization plan in order to consider the proceeding as successful.

On the other hand, the European Union, with special interest in restructuring plans, instead of the liquidation of the business, implemented Directive 2019/1023, in which among other topics, was established a Preventive Restructuring Framework. According to the PRF, businesses located in the European Union are ensured access to a preventive restructuring procedure that enables them to restructure their debts at an early stage of financial distress, which per se means that already insolvent debtors are not covered by this framework.

In the PRF, the debtor-in-possession scheme is a rule under these proceedings, stating that debtors may remain at least partially in control of their assets and course of business; however, the possibility to appoint an IP remains but under strict circumstances. Also, a stay of individual enforcement actions is available to debtors, only when it is shown that it would support the negotiations of a restructuring plan, nevertheless it is not automatic and it can be general or limited, issue that is assessed on a case-to-case basis.

Other important characteristic of the PRF is the involvement of creditors and assets. According to the Directive, not all creditors are included in the pre-insolvency proceeding, not all of them are going to be comprised in the reorganization plan, which means that not all of them are affected by the proceeding. Following this criterion, only affected parties are ought to vote the reorganization plan and, if the required majorities are reached, even dissenting parties are bind by the approved plan.

By last, the PRF included 'early warning tools' as an important feature. By these, it is intended to provide debtors and even creditors with effective mechanisms that make it easier to identify signs of difficulties that could imply insolvency in the future.

On the subject of the entry requisites to each proceeding (CIR and PRF), both call for the admission of debtors in certain state of financial difficulty, however not in the same way. On one hand, the Colombian restructuring proceedings are available not just for debtors in current financial difficulties (for which the implemented model was a mixture between the cash-flow insolvency and the balance sheet insolvency), but also for debtors that are on impending insolvency.

The PRF establishes that a debtor must be in a state of likelihood of insolvency in order to be admitted to this kind of pre-insolvency proceeding; however, the term was not defined by the Directive and it is to Member States to define the entry requirement. The term "likelihood" should be analyzed under a rational basis – applying some kind of test – while trying to predict the future financial state of the company within certain period of time.

Regarding the above, our work has led us to conclude that both, the CIR and the PRF open the admission of debtors to restructure their debts in a situation of future likely impossibility to pay debts or comply with liabilities as they fall due. However, as it was already shown, both proceedings involve different actors and imply different consequences related to the nature of the proceeding. One, more formal, involving all assets and all creditors, while the other one does not.

Even though the Colombian law includes 'impending insolvency' as an entry requirement, according to the data of insolvency proceedings provided by the Superintendency of Corporations, it is clear that debtors are not very likely to file for admission to reorganization proceedings in such cases and that, they prefer to wait for insolvency to be an issue instead.

As it was shown by different studies exposed in this paper, it is better to reorganize a business at an early stage and making it viable, issue that is only reached by a prompt and effective proceeding. As the abovementioned data was analyzed in this paper, findings of this study imply that the Colombian insolvency framework hardly provides for a timely, efficient, and impartial resolution for insolvencies, which means that it is failing to meet one of its main goals.

By last, this study has gone some way towards defining and designing a more effective restructuring proceeding for solving the issues regarding non-efficient and delayed solution of the insolvency crisis in the Colombian insolvency framework, mainly by limiting the involvement of the judge to situations where it is considered necessary and proportionate.

The characteristics or tools to be included in such mechanism, among others widely described on this paper, are:

- The proceeding shall be available to debtors in an impending insolvency or that are likely to become insolvent given specific circumstances, but which are not yet insolvent.
- Implementing early warning tools as a mechanism to help debtors in financial distress to notice when business is not going out as planned, in other words, when there is a likelihood of insolvency becomes a probable threat to the business.
- The commencement is voluntary for the debtor or its directors and should not be mandatory. At the same time, not all creditors are involved on it, but all affected parties should be notified of the start or existence of the negotiations.
- Stay of individual enforcement actions is available under request of the debtor and shall be granted only if it is shown that the enforcement of certain actions threats the advancement of the negotiations or impedes the approval of a reorganization plan.

These characteristics comprised in a new, out-of-court reorganization proceeding, could hypothetically lead to a more efficient insolvency regulation, letting debtors gather with their creditors to renegotiate and restructure debts and liabilities, with more guarantees that what a simple private negotiation can provide.

Taken together, these findings suggest that an alternative to be considered for the Colombian insolvency framework would be to implement a pre-insolvency proceeding which would begin before a debtor becomes insolvent but is likely to be if actions are not taken, with the debtor in possession and without the appointment of an insolvency professional,

requiring minimal court involvement and only affecting certain creditors or groups of creditors, which are forced by law to negotiate alternatives or solutions for the debtor's financial distress. A structured bargaining process, with almost no court involvement would be of huge significance and would contribute with a better administration of justice.

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