

Guatemala: Benefits and Challenges of Implementing a Modern Insolvency Legal System in the Context of the Current Global Crisis

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Synopsis

In Guatemala, there is no specific law regulating insolvency. The current legislation regulating insolvency was adopted in 1963. This presents a challenge given the current context and the economic crisis caused by COVID-19. It is necessary to update the regulation of insolvency in Guatemala so that companies and individuals in distress can meet their obligations, and a culture of reorganisation is implemented. Due to the current global crisis generated by the COVID-19 pandemic, it is necessary to determine whether approval of a proposed law initiative to regulate the aspects of insolvency would be feasible at this time, due to the challenges its approval and implementation involve.

The context of the economic crisis generated by COVID-19

As stated by the World Bank Group President:

‘Policy choices made today – including greater debt transparency to invite new investment, faster advances in digital connectivity, and a major expansion of cash safety nets for the poor – will help limit the damage and build a stronger recovery. The financing and building of productive infrastructure are among the hardest-to-solve development challenges in the post-pandemic recovery. We need to see measures to speed litigation and the resolution of bankruptcies and reform the costly subsidies, monopolies and protected state-owned enterprises that have slowed development.’¹

The COVID-19 pandemic has already had an impact on the world economy, including Guatemala. As a developing country, Guatemala was not prepared to deal with the pandemic. After years of not investing in

healthcare and having 70% of the population working in the informal economy², efforts began to be directed at the above issues to beat the crisis.

This led the country to apply for loans from multilateral entities such as the Inter-American Development Bank (IADB), and the Central American Bank for Economic Integration (CABEI) for USD 293,200,000, amount which is currently addressed to the healthcare infrastructure and an internal public debt in which the Central Bank of Guatemala acquired Treasury Bonds for GTQ 11,000,000,000 (approximately USD 1.5 billion) that is being directed to the population that depended on the informal economy, and all workers with contracts suspended by the crisis.

In the national environment, given the risk of spreading the virus, decree of State of Public Calamity, followed by Presidential Dispositions, dictated, and renewed since 16 March 2020 which, among others, suspend the work in different state dependencies as well as in the private sector, impose a shutdown of all commercial establishments or services of any nature, as well as a restriction of freedom of movement during established hours (curfew). Several traders and companies have questioned whether their operations will survive the following days, weeks and months, and have taken drastic safeguard measures to do so, including deferral of compliance with financial obligations and suspension of labour relations. This uncertainty is growing as the restrictions are prolonged, and as time goes by, the impact on the population increases. Companies need time to pay and reestablish equilibrium.

Current legislation of insolvency

In the event of a suspension or upcoming suspension of payment of obligations, the legislation in force in Guatemala since 1963 provides for an ‘out of court’ or extrajudicial procedure based on the possibility

Notes

- https://www.worldbank.org/en/news/press-release/2020/06/02/countries-can-take-steps-now-to-speed-recovery-from-covid-19?cid=SHR_SitesShareLI_EN_EXT
- D. Aguilar, ‘Banguat: informality represents 22% of GDP’, <<https://lahora.gt/banguat-informalidad-representa-un-22-del-pib/>>, 20 December 2019.

that the debtor makes a proposal to its creditors with the aim of concluding an agreement. Such agreement may contemplate aspects related to the assignment of assets, the total or partial administration of the asset by the creditors or by the debtor, under an intervention appointed by them, and issues regarding waivers and/or withdrawals that may be considered.

Adopting the extrajudicial procedure to achieve a successful restructuring requires extensive experience in financial and legal matters, risk management, and knowledge of the market to ensure the preservation of value and continuity of a business in progress, as well as a strategic analysis of communications, priorities and timing. Implementing this strategy requires discipline and attention to the concerns of the various stakeholders in a transparent and orderly manner.

Furthermore, the law contemplates the possibility of carrying out a judicial agreement that includes the causes of the suspension of payments, the origin and amount of each debt, its due date, guarantee and conditions, a draft of the agreement attaching the general balance sheet of the business, and the list of creditors. This judicial procedure includes submitting a potential restructuring process to a civil judge, including the appointment of a review commission and a provisional custodian to intervene in the debtor's operations, as well as the publication of the matter in the Official Gazette and another more widely circulated newspaper. This process, whose purpose is the approval or not of the agreement, is subject to judicial resolutions regarding reports, creditor requests, citations to interested parties and meetings, verification of credits, oppositions and annulments.

Having suspended the payment of obligations, a 'bankruptcy' proceeding would be necessary before a judge when the agreement proposed by the debtor has been rejected, and when there are 3 or more executions pending against the same debtor and there are not sufficient and available assets to cover the amounts claimed. Any of the creditors may request the process and a judge will declare it without prior notice. As a result, a judge will order the necessary measures to be taken such as the occupation of the debtor's assets, his accounting, business documents and correspondence, the appointment of a depositary, order of attachment to the debtor, and others. From the moment that the necessary state of insolvency is declared, all credits and obligations are considered to have expired, and interest will cease to run in favour of the creditors. While the final situation of the business is being resolved, current business operations may continue if the review committee deems it appropriate. If no agreement is reached between the debtor and its creditors, the judge may declare the state of bankruptcy and will order the debtor to be detained, unless it is determined that the insolvency is fortuitous or without negligence.

When the bankruptcy is determined, a receiver shall be appointed to represent the estate of creditors, and

the assets of the debtor shall be taken care of, an inventory and an appraisal shall be made, and the execution of the assets shall be attempted in order to make payments to the creditors according to a certain grading, who shall be called to a meeting for this purpose. The above also implies the intervention of a judge to obtain approval or not of the stages of the procedure. Both the bankruptcy and insolvency proceedings attract all pending claims against the debtor and will cease any foreclosures being pursued against the debtor, except those based on mortgage or pledge credits.

Once the process has been completed and the requirements have been met, the debtor may file for rehabilitation with the aim of recovering his rights and capacities to exercise the functions that would have been deprived to him as a result of his state of bankruptcy. As can be seen, under current conditions, a judicial bankruptcy process can lead to costly, lengthy and inefficient litigation to achieve the desired objectives.

A comprehensive vision that can be adopted for the implementation of the National Emergency and Economic Recovery Plan

On 18 March 2020, the President of the Republic presented the 'National Emergency and Economic Recovery Plan (Phase I)', which includes labor, fiscal, and regulatory measures to stimulate the Guatemalan economy. Among other measures, the Executive Branch is calling again for the approval of Bill 5157, seeking to modify the Law of Banks and Financial Groups, Decree 19-2002 in order to provide rescue mechanisms for banks, financial groups and regulated entities that may suffer a financial impact during the crisis.

The question is what restructuring mechanism for the preservation of value exists for those companies that, not being banks or financial institutions, will suffer temporarily or permanently from the crisis?

Guatemala does not have a modern legislation that allows for specialised agile mechanisms for cases of temporary crisis in which companies face default or similar. As explained above, the current legislation dates from 1963 and the mechanisms it offers are not updated, not having a modern insolvency legislation creates an obstacle to preserving the value of companies.

For this reason, in the face of financial difficulties, entrepreneurs opt primarily to restructure their assets or liabilities with an extrajudicial procedure, in order to normalise their commercial and financial relations. Every restructuring procedure is subject to an exhaustive analysis and evaluation. By means of an extrajudicial procedure of restructuring, it is intended that the interested parties obtain liquid funds to develop their commercial activity.

In response to the pressures experienced in the Guatemalan market, some trade associations have submitted proposals for immediate measures to the Executive Branch, aimed at preserving employment and

continuity of economic activity in the country. These proposals include that, in order to guarantee the flow of capital, regulations governing effective insolvency procedures should be promoted.

Since May 8, 2018, there is a Insolvency Bill in the Congress of the Republic, number 5446, which provides for the approval of the Insolvency Law, through which it is intended to provide Guatemalans with a modern instrument, agile, with a view to preserving value and restructuring liabilities, so that, in the medium and long term, companies can survive such crises, jobs can be preserved, and the economy, through processes and supply chains, continues to operate for the benefit of all. As established by the President of the Economy and Foreign Trade Commission in the Favourable Opinion of initiative 5446, the initiative 'seeks to promote a modern, uniform, orderly and agile regulatory regime, based in the first instance on the reorganisation of companies that has as its objective the partial or total recovery of recognised claims and the continuity of the debtor's activity.'³

The Insolvency Bill regulates the actions that could be taken by persons (individuals or legal entities) who are unable to meet their financial obligations and risk losing their companies, in order to reorganise them while maintaining their activities or to liquidate them (if that is the case) with a more agile and efficient process than the current one.⁴ Its main features are the updating of bankruptcy regulations, the facilitation of restructuring procedures, the implementation of modern tools that facilitate a simple, fast and efficient process, and the facilitation of asset recovery processes.⁵ The adoption of a modern regime includes benefits for both creditors and debtors, and this has an impact on the facilitation of doing business in the Guatemalan economy.

Even though the benefits that the approval of said draft Bill would have in Guatemala's economy are easy to see, it is important to analyse the feasibility of implementing such Bill in the current context and with the current resources that the Guatemalan Government has, which are mostly focused in overcoming the crisis and attending the immediate needs, and not on implementing instruments that would help the economy of Guatemala in the longer run. The Judicial system would also face a challenge with this implementation.

In the following sections, the benefits of the Insolvency Bill will be described to further analyse the challenges that said law implies, and then conclude on appreciations of whether the approval of the Bill would be beneficial and realistic for implementation at this time.

Benefits of the Insolvency Bill 5446

The current legislation that regulates the aspects related to insolvency, the Civil and Commercial Procedural Code from 1963, proposes an extrajudicial agreement, the insolvency proceeding, and the regulation of bankruptcy in Guatemala. So, if this already exists *why it is necessary to adopt a new specific insolvency law?*

This leads us to detail the benefits that Insolvency Bill 5446 would bring. These benefits are:

i. The proposal elaborates principles and concepts that would be the foundation for any matter in this area:

Article 4 of the Insolvency Bill sets out the guiding principles in the application and interpretation of the law. These are:

- (A) *Principle of vindication:* Every person, natural or legal, has the right to participate in the national economy. In the event of possible insolvency, reorganisation will be promoted as a suitable means to achieve recovery.
- (B) *Claim principle:* in the application of this law, creditors of the same type of claim shall be given equal treatment, as established in Article 56 of the law.
- (C) *Principle of legal unity:* this law brings together in a single body of law, material and procedural issues for better understanding and application.
- (D) *Principle of good faith:* the actions related to the negotiation and compliance with the reorganisation, bankruptcy and liquidation must be invested with the good faith of the parties, who must promote the non-litigious, public and informed negotiation.
- (E) *Principle of publicity:* the beginning of the bankruptcy proceedings, the existence of the reorganisation plan and the beginning of the liquidation shall be published.
- (F) *Principle of celerity:* the insolvency shall be resolved efficiently and quickly, avoiding the depreciation or loss of the assets.

Also, Article 5 of the Insolvency Bill defines certain concepts that are currently not defined by the Code of Civil and Commercial Procedure. Some of the concepts defined include the list of creditors, the reorganisation plan, insolvency, bankruptcy, establishment, and subordinate claim.

Notes

3 Idem.

4 Idem.

5 R. Callejas, E. Callejas, P. Montenegro and J.A. Marroquín, *Guatemala: The Future of Insolvency and Restructuring* (INSOL World, 2019), 22-24.

ii. The proposal sets and reduces terms to conduct an insolvency process:

The Insolvency Bill provides for a reduction in the terms to complete the procedures. One obstacle presented by the current legislation, is that it leaves to the judge's discretion the deadlines for the provision of requirements and the completion of some procedures. This does not contribute to the legal security and certainty of either the debtor or the creditor, and therefore this benefit gives a debtor or creditor a complete picture of the implications and timescales that an insolvency proceeding may entail.

iii. The proposal creates a Judicial Insolvency Gazette:

Article 64 of the Insolvency Bill creates the Judicial Insolvency Gazette as an official means of performing notifications of judicial insolvency proceedings. The Judicial Insolvency Gazette will be an electronic platform and free of charge consultation administered by the Judiciary Branch. This also helps to reduce terms given that the burden on the courts is not to be dealt with and wait for them to have the time to make a notification.

iv. The proposal establishes a broader and more detailed priority of claims:

Article 56 of the Insolvency Bill includes the Priority of Payments in its article 56 as follows:

(A) Privileged claims:

1. Claims with special privilege: secured by mortgage or those protected by a trust.
2. Claims with general privilege:
 - Claims of persons not considered to be specially related to the debtor, and which are given after the judicial declaration of bankruptcy for the continuity of the debtor's economic activity.
 - Labour claims of any nature due up to two years prior to the declaration of the bankruptcy.
 - Tax claims, due up to two years prior to the declaration of bankruptcy.
 - Claims relating to the obligation to provide child support declared in a final judgment.
 - Administrative expenses of the bankruptcy proceeding.

(B) Common claims: those that are not privileged or of second order.

(C) Second order claims:

1. Fines and other financial penalties of any kind;
2. Subordinated claims; and,
3. Claims of persons especially related to the debtor
 - An individual: a relative of kinship or family relationship;
 - Company: partners, administrators and related companies.

For any creditor who may be taking part in a restructuring or liquidation process, it is vital to have a clear understanding of how your claim ranks in priority to all other claims and how your legal rights are affected. The Insolvency Bill provides this knowledge for creditors.

v. The proposal specifies the remedies that may be filed in the insolvency proceedings:

Among the remedies that can be used throughout the procedure, are:

- (A) Bankruptcy Incident: in all cases in which the law does not establish a special procedure or term, the oppositions, challenges and other controversies that arise during the procedure of the bankruptcy will be substantiated before the Bankruptcy Judge himself through an incident.⁶
- (B) Remedies: court decisions issued in insolvency proceedings may only be challenged by means of the appeals for reversal and revocation, as regulated in the Civil and Commercial Procedural Code and the remedy of appeal specified in the same Insolvency Bill.

Doing business

Guatemala is the country with the largest economy in Central America, surpassing Belize, Costa Rica, El Salvador, Honduras and Nicaragua. However, in the Doing Business index (WB) of 2020 pertaining to the ease of conducting business in several jurisdictions, El Salvador and Costa Rica are positioned above Guatemala. Globally, Guatemala was ranked 96th out of 190 countries evaluated. This is due to different factors that are evaluated by the World Bank, among them, resolving insolvency.

Notes

⁶ According to Article 135 of the Judicial Branch Law, an incident is any ancillary matter that occurs and is promoted on the occasion of a trial and that has not a specific procedure indicated by law.

The topic with the lowest score received for Guatemala was *resolving insolvency*, with a score of 27.6, occupying the place 157 of 190. This is worrisome considering that the crisis generated by COVID-19 will have an impact on companies already on distress and creditors. Maintaining business operations and preserving value should be a major concern of insolvency law. Developed insolvency legislation should avoid the premature liquidation of businesses that are sustainable in the long term, giving both the debtor and its creditors the necessary tools to be secure. This legislation should provide a change of culture, from criminalising insolvency, to providing a fresh start and practical solutions supporting businesses that contribute to our country's employment and economy.

Enacting the Insolvency Bill initiative, reviewed to include certain aspects that were left out by the Economic Commission of Congress, would not only support those who currently need a procedure to restructure their assets and liabilities, it would also help the country to have better ratings worldwide in terms of resolving insolvency, and as a result, this may facilitate and attract foreign investment which will be determinant to overcome the current crisis.

Aspects that shall be reviewed include electronic notifications, measures to address cross-border proceedings, simplified procedures, enterprise groups insolvency, frameworks for SMEs, among others.

Post-implementation challenges of draft Bill 5446

Insolvency proceedings are currently brought before an ordinary judge of first instance. However, draft Bill

5446 presents a challenge for the Judiciary Branch since implementing this law would imply the creation of a structure for insolvency matters, and also implies the need of judges specialised in the matter, and this is materially impossible to implement in the short-term at this moment.

The above represents an investment of time, effort and money for the Judicial Branch. The crisis generated by the COVID-19 has represented a challenge for the Judicial Branch since it has not invested in technology for years and is currently unable to conduct virtual hearings and make notifications by effective electronic means. However, progress is being made.

Therefore, upon the opportunities that the Insolvency Law may bring, there is concern that the Judicial Branch may not direct or execute the necessary immediate investment for the practical implementation of this new regime.

Conclusion

As pointed out by a contribution written for World Bank, weak insolvency frameworks can also leave so-called 'zombie' companies limping along, operating but dependent on rolling over credit, unable to invest in new activity and starving healthy businesses of credit⁷.

The approval and implementation of the Insolvency Bill in Guatemala presents a challenge for the Executive Branch, the Legislative Branch, and the Judiciary Branch in developing budgetary provisions, legal certainty, and logistical means, infrastructure and training in this area. However, the benefit of having a modern restructuring regulation to deal with the economic effects of the current State of Public Calamity will last over time.

Notes

7 <https://blogs.worldbank.org/voices/strengthen-insolvency-frameworks-save-firms-and-boost-economic-recovery>