Recent Developments in Dominican Insolvency Proceedings

By **MARY FERNÁNDEZ** *and* **MELBA ALCÁNTARA**

As of February 7, 2017, insolvency proceedings in the Dominican Republic are governed by the New Insolvency Law No. 141-15 on Restructuring and Liquidation of Companies and Businesspersons (the "**New Insolvency Law**").[1] The New Insolvency Law and the related Regulation[2] replace the old insolvency regime, which was outdated, obsolete[3] and only provided for the liquidation of the debtor. The New Insolvency Law, in contrast, provides for the possibility of a debtor's reorganization—a welcome change that should be a value-enhancing development for debtors and creditors alike.

During the first year following the New Insolvency Law coming into effect, 17 cases have been initiated. Although many were dismissed on the grounds that they were not properly filed (e.g., failure to meet the procedural filing requirements or filing made solely to avoid paying taxes), investors would be wise to watch closely. Two ongoing cases in particular, Caribbean Recycling S.R.L. and Pan Am World Airways Dominicana, S.A., may serve to determine the ability of the New Insolvency Law to handle larger restructurings with complex aspects typical of international restructurings. Specifically, the restructuring of Caribbean Recycling may be the first to include debtor-in-possession (DIP) financing. Pan Am World, on the other hand, will test the New Insolvency Law's ability to handle a more complex restructuring, as this debtor has more than 200 creditors and nearly USD40 million in liabilities. We will discuss those two test cases in more detail later on.

The remainder of this article is divided into four parts: (1) a brief overview of the New Insolvency Law, (2) highlights of some of its more unique features, (3) an overview of restructuring proceedings that have been commenced under the New Insolvency Law and (4) a brief conclusion and the authors' views on the future.

Overview

The New Insolvency Law contemplates two different proceedings: the reorganization of entities or businesspersons experiencing temporary financial difficulties, and the liquidation of insolvent entities incapable of carrying on business.

Who May Be a Debtor

Potential debtors under the New Insolvency Law include Dominican or foreign incorporated companies (or individual businesspersons) with their domicile or continuous presence in the Dominican Republic. Although seemingly broad at first glance, notably, the New Insolvency Law excludes a number of entities, including (i) state-controlled entities, (ii) companies participating in the electric sector, (iii) financial intermediaries, (iv) securities intermediaries, (v) investment fund managers, (vi) centralized securities depositories, (vii) stock exchanges, (viii) securitization companies and (ix) any other entity considered to be a stock market participant, with the exception of publicly-traded companies and companies governed by the Securities Market Law (as amended).[4]

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Commencing a Proceeding

A proceeding is commenced through a written petition to the court by either the debtor or its creditors where one or more of the following conditions are met.

Conditions for Debtor to Become Subject to a Restructuring (Whether Voluntary or Involuntary)

- Failure to pay claims regarded as certain, due and payable under Dominican law for a period of more than 90 days, after formal notice to pay;
- Debtor's current liabilities exceed the current assets for a period of more than six months;
- Failure to pay withheld taxes to the tax authorities for a period of more than six fiscal quotas;
- Failure to pay two consecutive salaries to employees on the corresponding payment date, subject to certain exceptions;
- Closure of the business is ordered because of the absence of the administrators, as well as the transfer–partial or total–of its assets to a third party for distribution to all or some creditors;
- Use of deceitful or fraudulent practices, criminal association, breach of trust, falsehood, simulation or fraud to default creditors;
- Notification to creditors of the suspension of payments by the debtor, or of the intent to do so;
- Commencement of a foreign insolvency proceeding in the jurisdiction of the debtor's parent company or of its main place of business;
- Foreclosure of more than 50% of the debtor's total assets; or,
- Decisions or sentence-enforcement procedures that may affect more than 50% of the debtor's total assets.

Voluntary Restructuring

The New Insolvency Law provides the possibility for the debtor to request the initiation of a voluntary insolvency proceeding. The restructuring petition submitted by the debtor must be accompanied by (i) a report explaining the debtor's economic condition and justifying the need for restructuring, (ii) a list of all creditors and the status of all claims and liabilities, (iii) the debtor's financial statements for the last three fiscal years, (iv) an authorization by the debtor's management approving the restructuring petition and certain other documentation.

Within 120 days after the appointment of the Conciliator (discussed below), the proposed restructuring plan must be presented to the creditors for approval or rejection. There are no voting classes. Each creditor has the right to one vote for every 1% (or portion higher than 0.5%) of the total registered or recognized debt which it validly holds.[5] Decisions are made with 60% approval as measured based on creditors actually casting votes.[6] An approved restructuring plan is binding on all non-consenting creditors, except for those whose claims are privileged or secured. In the event that the creditors reject the proposal, the liquidation of the debtor may follow. However, if approved, the restructuring plan must be presented to the court for verification and approval.

Involuntary Restructuring

If the debtor is facing any of the situations that qualify it to initiate a reorganization process (see above), any creditor who is owed the equivalent of 50 monthly minimum wages or more (approximately USD13,190.00) may petition the court for the debtor's restructuring.

The restructuring petition filed by creditors, together with all the documents presented to the court in support of the involuntary petition, must be noticed to the debtor.

Post-Filing Process

Once the petition for restructuring is filed, the court has an obligation to appoint a Verifier, who will have the duty to verify the debtor's financial situation and inform the court thereof. The Verifier may be assisted by experts and has ample powers to obtain information about the debtor's estate. Following the verification process, if the restructuring petition is accepted by the court, then notice thereof must be provided to the debtor and the creditors.

The court will then appoint a Conciliator, whose principal role is to mediate between the debtor and its creditors in order to reach a restructuring agreement. Upon appointment of the Conciliator, the conciliation and negotiation process is initiated. The New Insolvency Law calls for the ordinary functioning of the debtor and the business during the conciliation phase. Thus, during this process, the management of the assets continues to be handled by the debtor but remains subject to supervision by the Conciliator.

The New Insolvency Law also provides mechanisms for the participation by interested parties in the restructuring process. During the review of the restructuring petition and for as long as the restructuring process is ongoing, the creditors have the right to appoint an advisor to collectively represent them during the insolvency process.[7] Creditors holding publicly traded debt securities can also separately appoint an advisor. Likewise, the employees of the debtor may also separately appoint an advisor.

Key Players in Dominican Restructurings Other Than the Debtor and its Creditors

— **Verifier**—appointed immediately after a restructuring petition is received by the court, the Verifier's role is to review the debtor's financial condition and report to the court on the same.

— **Conciliator**—appointed after a restructuring request has been formally accepted by the court, the Conciliator's principal role is to mediate negotiations between the debtor and its creditors in order to reach a restructuring agreement.

— **Creditors' Advisor**—appointed at the election of a debtor's creditors, the Creditors' Advisor can represent creditors generally and advise the debtor as to their collective interests.

— **Representative of Publicly Issued Securities**—appointed as the election of creditors holding publicly traded debt securities, the Representative of Publicly Issued Securities can represent holders of public debt and advise the debtor as to their collective interests.

— **Employees' Advisor**—appointed at the election of a debtor's employees, the Employees' Advisor can represent labor creditors and advise the debtor as to their collective interests.

Upon initiation of the conciliation and negotiation process, all judicial, administrative or arbitral decisions that affect the assets of the debtor and any enforcement or eviction regarding the debtor's property (real or intangible) are stayed until the reorganization is approved. However, certain obligations are not subject to a stay, such as labor and social security obligations and payments made in the ordinary course of business. Moreover, if the proceeding ultimately converts into a liquidation (see below), then the stay ceases to be in effect.

The Restructuring Plan

As noted above, once a restructuring petition is accepted by the court, a Conciliator shall be appointed in order to help broker a restructuring plan.[8]

The restructuring plan, which must be presented by the Conciliator to the court within 120 days from the Conciliator's appointment (subject to a potential 60-day extension) must contain, at least: (i) the debtor's background; (ii) a summary of the restructuring plan, with a clear description of its main characteristics; (iii) information concerning the financial situation of the debtor; (iv) non-financial information of the debtor that may impact its future activity; (v) a description of the future operations of the debtor and the effects of the restructuring; (vi) potential financing needs and the costs related to the proceedings; and (vii) a payment plan for the debtor's liabilities and the debtor's business plan for at least the following five years.[9]

If the restructuring plan is approved by the creditors, it must be presented to the court for verification and subsequent approval. In determining whether to approve the plan, the court will consider, *inter alia*, the propriety of terminating existing contracts, issuing new debt, the collateralization of new obligations and the potential sale of assets outside of the ordinary course.[10] Once approved by the court, the Conciliator shall oversee compliance with the plan.

Reorganization cases are formally concluded with the consummation of the reorganization plan. However, if the restructuring plan is not approved by the judge or has been rejected by creditors, judicial liquidation of the debtor may follow.[11]

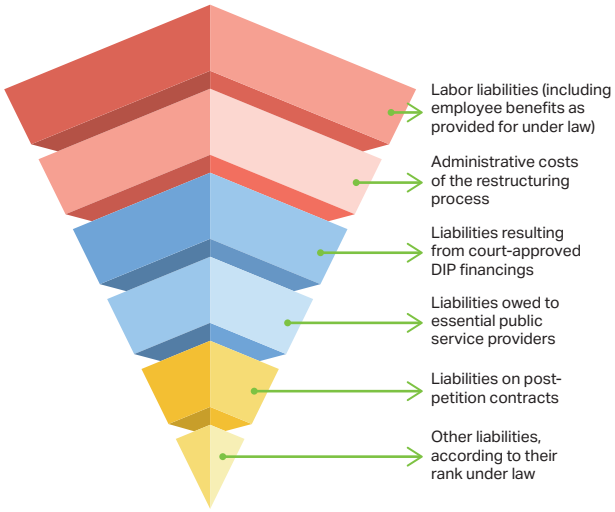
Liquidation

The new insolvency framework establishes that the Verifier, at the beginning of the restructuring process, and the Conciliator, during the negotiation phase, may recommend the immediate liquidation of the debtor under specific circumstances, including where the debtor is uncooperative or if the restructuring is not feasible. The judicial liquidation of the debtor may also be requested by the Conciliator, any recognized creditor or by decision of the majority of creditors in the event of non-compliance with the terms of an approved restructuring plan. A debtor may also request its judicial liquidation voluntarily at any time during the proceedings.

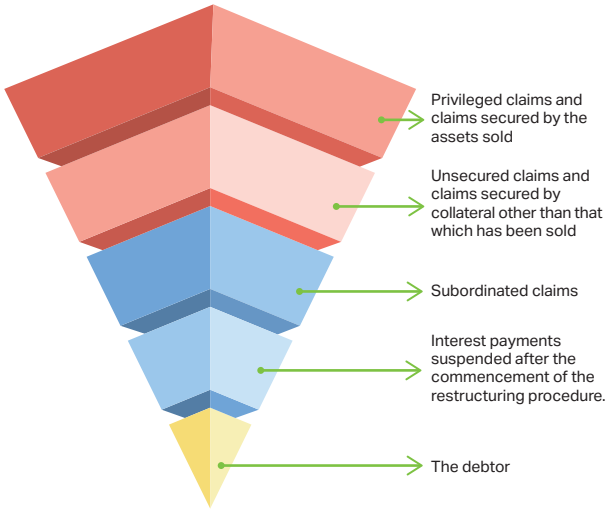
The notice of the judgment that orders a judicial liquidation entails the immediate loss by the debtor of its right to manage and dispose of its property until the judicial liquidation process has concluded. The court must designate a Liquidator, who will act as the administrator of the liquidation process and assume all management functions and rights of the debtor. During the judicial liquidation process, the rights and actions of the debtor are exercised by the Liquidator.

Priorities

Although under certain circumstances creditors can agree to different treatment, the New Insolvency Law provides for the following priority scheme, which prioritizes labor creditors over all others.



Additionally, in the case of an asset sale, the New Insolvency Law and corresponding Regulation provide that distributions will be made on a *pro-rata* basis to creditors according to the following priorities:



Key Features of the New Insolvency Law

In addition to the core features of the New Insolvency Law discussed above, the New Insolvency Law also includes a number of features designed to facilitate successful reorganizations, including on an expedited basis.

Pre-pack Agreements

The New Insolvency Law provides for pre-pack arrangements, which may be presented by the debtor to the court in connection with a voluntary restructuring petition where the debtor has reached a restructuring agreement with a group of creditors whose claims represent 60% of the debtor's total liabilities prior to the filing of a petition.[12]

Notably, the Regulation accompanying the New Insolvency Law establishes the possibility of reaching an agreement with one or with several categories of creditors, including (i) local and foreign financial entities; (ii) bondholders; (iii) providers or suppliers; (iv) labor liabilities; (v) state entities; and (vi) other creditors. Different actions and stipulations may be agreed for each class.[13]

As with the restructuring process discussed above, the debtor and its management continue functioning normally during the approval process of the pre-pack agreement. Thus, the management of the debtor's assets continues to be handled by the debtor but remains subject to supervision.

The proposed pre-pack agreement may also be accompanied by a proposal for appointment of a specific Conciliator, which shall be confirmed by the court, provided that the plan is accepted. This Conciliator has the same attributes and obligations of a Conciliator designated in a voluntary or involuntary restructuring process. The approval of the pre-pack agreement shall be notified to the debtor and the creditors and will produce the same legal effects as a restructuring plan.

DIP Financing

The New Insolvency Law establishes that debts incurred post-petition have a higher priority in relation to all other secured and unsecured claims of the debtor, with the exception of tax claims, employee claims and claims resulting from the payment of the restructuring process, which are entitled to a higher priority status.

In addition, the New Insolvency Law also includes the concept of post-petition DIP financing and establishes a priority for its payment. New financing must have the approval of the court and the petition presented by the Conciliator may be objected to by creditors or other parties in interest. The approval of new collateral in connection with DIP financing may also be authorized by the court, although the court will likely ask

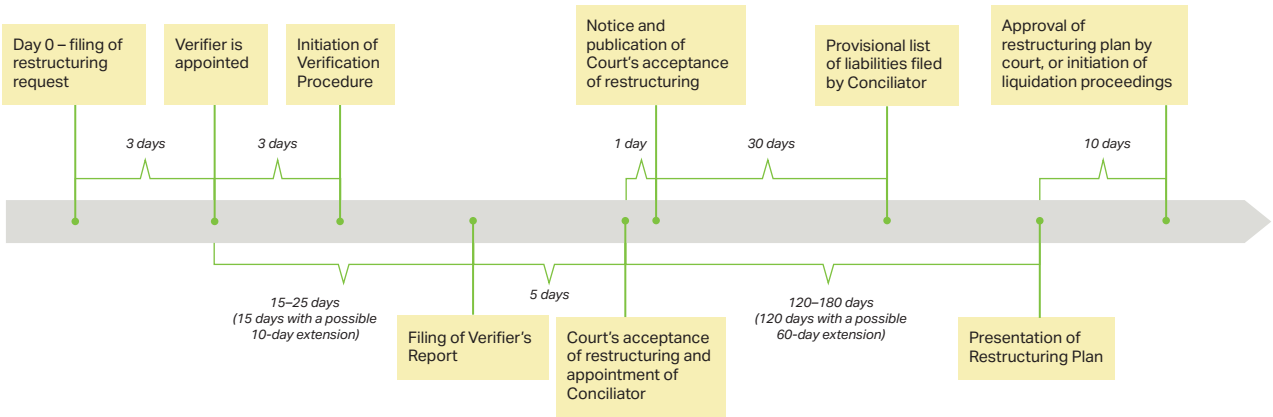
to hear from the Creditors' Advisor before approving such arrangements.[14] Notably, while the court can approve the pledging of new collateral, the court may not grant a DIP lender a senior lien on already encumbered property. Instead, if existing collateral is pledged, new liens on the collateral will be junior to existing liens and such pledge can only occur with the approval of existing lienholders.

New Specialized Restructuring Courts

Importantly, the New Insolvency Law creates new specialized courts with special jurisdiction to hear restructuring and judicial liquidation proceedings, which will consist of courts of first instance and of appeal (collectively, the "**Restructuring and Liquidation Courts**"). However, until the new jurisdiction takes effect (which may be some time given budgetary constraints), the Council of the Judiciary Branch has authorized two lower civil and commercial courts and two courts of appeals (in Santo Domingo, the capital city, and in Santiago, the second largest city in the country) to hear cases filed under the New Insolvency Law.[15]

The Restructuring and Liquidation Courts will be competent to hear all actions related to a restructuring plan, as well any other judicial or extrajudicial action linked to the debtor. The Restructuring and Liquidation Courts will also be competent to hear all possible measures to preserve the debtor's assets, including petitions for precautionary measures and protective actions. The only litigation related to the debtor that remains

Indicative Timeline: Key Milestones and Deadlines in Dominican Restructuring Proceedings



generally outside the purview of the Restructuring and Liquidation Courts is civil or criminal actions for non-compliance with the New Insolvency Law, which shall remain under the jurisdiction of the ordinary courts.

Arbitration

Consistent with the worldwide trend toward preferring arbitration, under the New Insolvency Law, any controversy arising during a restructuring procedure or derived from the execution of the restructuring plan may be subject to resolution before institutional or *ad hoc* arbitration. However, administrative actions related to the restructuring process, as well as all actions related to the liquidation, remain within the exclusive jurisdiction of the Restructuring and Liquidation Courts. If an arbitration is initiated, it will not be a cause for the suspension of the restructuring process.

Cross Border Insolvency Framework

In a particularly noteworthy effort to modernize the Dominican insolvency framework, the New Insolvency Law also sets forth a legal framework applicable to cross-border insolvency proceedings, developed in accordance with the United Nations Model Law on Cross-Border Insolvency (the "**UNCITRAL Model Law**").

Consistent with other jurisdictions where the UNCITRAL Model Law has been implemented, the New Insolvency Law provides that foreign creditors have the same rights and can rely on the same remedies available to local creditors, and it contemplates the possibility of processing local and foreign insolvency proceedings simultaneously, where the local court shall collaborate and coordinate its actions with those in the foreign proceeding.

After the recognition of a foreign main insolvency proceeding, a local restructuring procedure can only be initiated if the debtor owns assets located in the Dominican Republic. The effects of said procedure are limited to the assets located in the Dominican territory, as well as any other assets that pursuant to the New Insolvency Law shall be administered in accordance with the same.

As a practical matter, the addition of a cross-border insolvency framework opens up the possibility that debtors in the Dominican Republic that are Chapter 11-eligible in the U.S. could effectuate a comprehensive restructuring by pairing a Chapter 11 proceeding with a local proceeding in the Dominican Republic, the latter of which would function much like a Chapter 15 proceeding in the U.S.

Claw-back Period and Null Transactions

Under the New Insolvency Law, transactions made within a period of 2 years prior to the filing date of the reorganization petition may be clawed back where the court deems that they constitute an unjustified diversion of assets or are detrimental to creditors (similar in concept to a fraudulent transfer under U.S. law). The annulment action may be brought by any creditor or the Conciliator.

Although evidence may be presented to the contrary, the New Insolvency Law also expressly declares several transactions to be per se null and void based on a presumed detriment to the estate, such as (i) the cancellation or partial or total relief of debt by the debtor; (ii) transfers of assets free of charge or at a price below market value; (iii) transfers of property in favor of creditors which result in the payment of a higher amount to that received as a result of the liquidation; (iv) when the intended consideration is worth less than the obligation

performed, or vice versa; (v) payments of obligations not yet due; and (vi) transactions with related entities or companies where the debtor or any of the creditors serve as an administrator or are part of the administrating body, represent (jointly or separately) at least 51% of the subscribed and paid-in capital, hold decisive power at the shareholder assemblies or are in the position to name the majority of the members of the governing body.

Expedited Restructuring Procedure

Separate from the provisions allowing for a prepackaged restructuring, the New Insolvency Law establishes a special expedited procedure for restructuring when the total liabilities of the debtor do not exceed DOP10 million (approximately USD202,500.00). This expedited procedure cuts by half all applicable deadlines. Under the expedited procedure, the appointment of the Creditor's Advisor and of Auxiliaries for the Conciliator will not be applicable, and the minimum liability required by the Law for the filing of a restructuring petition is at least 15 minimum wages (equivalent to approximately USD3,960.00).

Empirical Overview and Case Studies

Despite criticism by many stakeholders of its extremely short deadlines and the perceived excessive powers allocated to the court, after its enactment, the New Insolvency Law should serve as a beacon of encouragement for investors, local and foreign, and has significantly improved the conditions for negotiations between debtors with their creditors and the prospects of successful restructurings. A year and a half after the entry into force of the New Insolvency Law and its accompanying Regulation, we can say that the courts and the officials appointed pursuant to the New Insolvency Law are taking its implementation very seriously and the same is progressing, albeit encountering certain obstacles which will be resolved as judges gain more experience and confidence in the procedure.[16] Additionally, sector-specific regulations are still in the process of being harmonized with the provisions of the New Insolvency Law.

As of July, 2018, 17 restructuring petitions have been filed, most of which were voluntary petitions filed by small-scale businesspersons to avoid the fulfillment of overdue liabilities. However, only three petitions have been accepted by the court; all other restructuring petitions have been rejected for failure to comply with the requirements set forth by the New Insolvency Law.

Although small in number, the ongoing restructuring proceedings are worth following and should provide some insight into the New Insolvency Law's capability for handling complex restructurings. For example, Caribbean Recycling's restructuring[17] was commenced on an involuntary basis following a petition from a creditor bank, notwithstanding the appointed Verifier's statement expressing doubts about the debtor's ability to successfully effectuate a restructuring. The judge decided to open a restructuring procedure and a Conciliator has been designated. Market rumors indicate that the judge's preference to pursue a restructuring may have opened a door for a possible DIP financing to restore the company's viability. The process is still ongoing.

The most high profile restructuring commenced to date is of PAWA, a local aviation company with more than 220 creditors and whose total debt amounts to an estimated nearly USD40 million. In this case, the court deemed the appointment of a Verifier unnecessary and immediately approved the restructuring petition, understanding that there was no need to inquire further into the debtor's financial condition. A brief case study for PAWA follows.

Case Study: Pan Am World Airways Dominicana, S.A.

- Although PAWA had been facing financial difficulties for over a year, its February 2018 voluntary restructuring petition was driven primarily by (i) the announcement by the Dominican Airports Consortium of the XXI Century of the suspension of services provided to PAWA Dominicana and (ii) the suspension of PAWA's operations by the Dominican Institute of Civil Aviation (IDAC).
- At the time of its filing, PAWA had more than 200 creditors and nearly USD40 million in liabilities.
- Although the court readily accepted PAWA's case and determined that there was no need to make a further inquiry into PAWA's financial state, the case has received widespread criticism from specialists which emphasized that an earlier filing would have avoided significant deterioration to the debtor's financial state.
- PAWA's restructuring remains ongoing, and in parallel, the Civil Aviation Board and IDAC jointly filed a criminal lawsuit against PAWA, alleging prepetition fraudulent transfers in connection with the nonpayment of aeronautical and airport fees.
- PAWA's restructuring will be an important test for the New Insolvency Law and its ability to handle a complex, multi-faceted restructuring involving hundreds of creditors (including governmental creditors) with disparate interests.

Conclusion

The insolvency framework embodied in the New Insolvency Law has positioned the Dominican Republic to compete with other jurisdictions that promote economic growth through the establishment of modern and transparent business regulations. This New Insolvency Law will help preserve and even create incentives for existing as well as new jobs, and may serve as an incentive for foreign investors to come to the Dominican Republic with confidence that in the event of financial difficulties, their investment will be subject to a fair, effective and predictable reorganization procedure.

The authors also predict that pre-pack agreements will be widely used by Dominican debtors and creditors, since they significantly improve the conditions for an amicable negotiation of the terms of the plan, and significantly reduce the costs and timeframes involved in the restructuring proceeding.

Nonetheless, based on the restructuring petitions filed before the courts to date, the authors agree that for the purpose of achieving a successful reorganization and optimizing the solutions set forth by the New Insolvency Law, it is critical that both creditors and debtors increase their diligence levels for the purpose of identifying indicators associated with a potential insolvency, in order to avoid the need to request the reorganization of the debtor once it is too late. ■

1. Signed into law on August 7, 2015.
2. Regulation for the Application of Law No. 141-15, enacted by Decree No. 20-17 issued by the Executive Branch on February 13, 2017.
3. The old insolvency regime dated back to 1956 and was grounded in the Napoleonic Code.
4. Law No. 249-17 on the Securities Market of the Dominican Republic, dated December 19, 2017.
5. However, with the exception of the case where there is only one creditor, one registered or recognized creditor cannot hold more than 50% of the votes, regardless of the size of its claim.
6. The quorum for creditor's meetings is the number of creditors which represent more than 50% of the total liabilities (registered or recognized) with a right to vote.
7. As with plan approval, the Creditors' Advisor may be appointed with the support of 60% of voting creditors.
8. A highlight of the new restructuring framework is the existence of effective tools for obtaining the information required for an appropriate evaluation of the debtor's situation and devising a successful plan. Additionally, debtors are provided with substantial flexibility in structuring plans, and the New Insolvency Law contemplates the possibility of effectuating a restructuring plan through the constitution of a trust formed in accordance to the provisions of Law No. 189 on the Development of the Mortgage Market and Trusts in the Dominican Republic.
9. Although the New Insolvency Law generally allows debtors to effectuate a comprehensive restructuring, it also provides that certain assets are excluded from the restructuring, including, *inter alia*, those in which third parties, rather than the debtor, have a beneficial interest (e.g., tax withholdings that while in possession of the debtor, must be remitted elsewhere as a matter of law).
10. If the restructuring plan is not proposed by the debtor, the debtor's approval is required as well (in the case of corporations, the plan shall be approved by the debtor's competent governing body).
11. If the plan is not approved by the requisite majority of the creditors, the Conciliator may recommend the liquidation of the debtor to the Court (or, time permitting, propose a new, revised plan to the creditors). Moreover, if the parties do not reach a restructuring agreement within 120 days from the Conciliator's appointment (subject to a 60-day extension), the Conciliator shall submit to the Court the termination of the restructuring process and request the judicial liquidation of the debtor.
12. The approval of the Representative of Publicly Issued Securities is also required, if applicable.
13. Pre-pack agreements that include all creditors must be approved by a group of creditors whose claims represent at least 60% of the total liabilities of the debtor. Pre-pack agreements that restructure debt of one or several categories of creditors must be approved by a majority whose claims represent at least 60% of the total liabilities of that category. The approval of a pre-pack agreement produces the same legal effects as a restructuring plan. However, pre-pack agreements that restructure debt of one or several categories of creditors do not affect creditors of other categories.
14. While it has no direct role in restructuring proceedings, the Monetary and Financial Administration, pursuant to a mandate under the New Insolvency Law, has adopted regulatory measures to, *inter alia*, ensure that the credit ratings of the debtor and its operations are not adversely impacted by new contingencies or provisions that are unforeseen at the time a restructuring petition has been filed. The adoption of these regulatory measures promotes DIP financing and was integral to gaining the support of the banks for the New Insolvency Law, since it effectively lowers the amount that financial institutions are required to reserve when making DIP loans by protecting against swift and unexpected credit downgrades.
15. Act No. 44-2016, dated December 7, 2016.
16. Given the recent enactment of the New Insolvency Law, several difficulties have been overcome by the court in its implementation. In the first two restructuring petitions filed, the court was forced to create *ad hoc* lists of professionals referred by the Institute of Certified Public Accountants for the purpose of selecting the Verifiers and Conciliators that would be appointed to such cases, given that the lists of registered officials had not been created by the competent entity.
17. *BHD v. Caribbean Recycling, S.R.L.*, Court of First Instance of Restructuring and Liquidation of the National District, Resolution No. 974-2017-SCON-00002, File No. 974-2017-ECON-00002 (August 9, 2017). Restructuring petition filed on August 2, 2017.

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Mary also actively participates in the drafting and revision of bills and regulations, including the current laws regarding intellectual property and commercial arbitration, and actively participated in the drafting of the New Insolvency Law.

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