

A New Approach to Bankruptcy in the Dominican Republic

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On March 30, 2007, the executive branch of the government of the Dominican Republic sent a new legislative proposal meant to address bankruptcy issues to its Congress. If approved by both chambers of Congress, it would replace its current approach to bankruptcy—which is antiquated, inefficient and essentially unused, and one that has failed to meet the needs of the many business failures created in the wake of a collapse of many of the country's major banks in 2003.



Josefina McEvoy

Current bankruptcy law in the Dominican Republic is a product of its interpretations of a Code of Commerce originally imposed on the nation during a period of Haitian domination from 1821-44. The elements of this

Code have remained unchanged since the early 19th century, except for those provisions created in Law Number 4582 in 1956, which established a compulsory preliminary conciliation proceeding before a creditor could institute a bankruptcy proceeding against a debtor. Since that time, bankruptcies have often ended at that compulsory preliminary stage of the proceedings and as a consequence, court precedents regarding bankruptcy matters in the Dominican Republic are practically nonexistent. Adding to this inefficiency, current bankruptcy rules only deal with liquidation, never contemplating reorganization and providing no guidance in matters of international insolvency.

The new proposed bankruptcy law can be seen as a consequence of the Dominican Republic's incorporation in free trade structures, on which the adoption of modern and efficient legal

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provisions enabling the reorganization of distressed business enterprises has been considered an urgent matter to be addressed. It is mostly the work of a special committee in charge of drafting, revising and promoting the new law. The committee was created by the Consejo Nacional de la Competitividad (National

Council for Competitiveness), an organization involving both the public and the private sector and created by a presidential decree with the main purpose of formulating, implementing and developing strategies for the key productive sectors of the Dominican economy, aiming toward a better response to the current challenges posed by the processes of globalization and free trade. Currently in force, the Dominican Republic had already ratified by September 2005 the U.S.-Dominican Republic-Central America Free Trade Agreement (DR-CAFTA), the largest free-trade agreement in over a decade to be agreed upon among the signatory nations.¹

The law is currently branded as the Ley de Reestructuración Mercantil y Liquidación Judicial (Law on Commercial Reorganization and Judicial Liquidation). Drafts of the law began circulating by May 2005 for review and consideration by main sectors of the Dominican Republic.

¹ The following nations are also parties to the DR-CAFTA: Costa Rica, El Salvador, Guatemala, Honduras and Nicaragua.

The committee appears to have used the U.S. Bankruptcy Reform Act of 1978 and its amendments as its comparative sources, particularly its chapters 5, 7, 11 and 13. It also employed the legislation on insolvency and bankruptcy of Canada (Bankruptcy and Insolvency Act of April 27, 1997 and the Companies' Creditors Arrangement Act of 1985), Mexico (Ley de Concursos Mercantiles de Mayo de 2000) and Spain (Ley Concursal del 9 de Julio de 2003).

For the chapter on cross-border insolvency, the committee resorted to the Model Law on Cross Border Insolvency, promulgated in 1997 by the United Nations Commission for International Trade Law (UNCITRAL).

With respect to the proceedings related to the judicial liquidation of a business, the law maintains the French approach previously resorted to by the drafters of a proposal for a new Code of Commerce, which, for a considerable

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time, has been pending congressional approval. In addition to preserving the option of judicial liquidation, the proposed law provides an approach toward the reorganization of enterprises before the Chamber of Commerce, following the spirit of Law No. 4582 of 1956, which established and made mandatory certain preliminary amicable settlement proceedings before any creditor could initiate judicial bankruptcy proceedings under the old rules.

The present law permits only merchants to file a petition for bankruptcy relief but unlike the old legislation, which made only sole business proprietors eligible to be debtors, the new law also considers business enterprises to be eligible to be debtors. An individual not engaged in business is ineligible for reorganization or liquidation under the new law.

The special laws recently promulgated to regulate the insolvency of financial institutions, energy providers and distributors, insurance companies and pension funds should remain unaffected, as the proposed bankruptcy law tracks those regulations and may in

fact supplement the insolvency proceedings contemplated by the special regulatory laws.

Under the proposed law, an eligible debtor may file, with the Chamber of Commerce in the jurisdiction in which the debtor maintains its domicile or place of business, a voluntary petition for relief if the debtor is insolvent or has ceased paying its debts as they came due. Further, one or more creditors holding claims in a qualified amount that also comply with certain requirements may file an involuntary petition against a debtor. The filing of a petition does not determine eligibility to be a debtor under the new law. Upon presentation of the petition, the Chamber of Commerce must designate a “visitor” or “auditor” from a panel of qualified professionals maintained in the Chamber’s special registry, who is charged with the task of verifying the accuracy or incorrectness of the petition. The Chamber must also publish the petition and give notice to the petitioner’s creditors at the expense of the petitioner.

If the petition is accepted, the Chamber of Commerce must then designate a “conciliator,” also from a professional panel that the Chamber will maintain for such purposes. This conciliator is responsible for, among other things, formulating and negotiating a reorganization plan, evaluating and recommending the disposing of pre-petition agreements to which the debtor is a party, and overseeing the operation of the debtor’s business subject to oversight and the approval of a simple majority of the debtor’s creditors. The reorganization plan must be approved by a majority of the creditors holding allowed claims, representing a qualified portion of the aggregate debt.

Remarkably, the proposed law permits the debtor’s management to continue to operate the business. In a reorganization case, operation of the business will be the rule, and the debtor’s management will be removed and replaced by a judicial administrator for

cause. The law also permits debtor-in-possession (DIP) financing following the initiation of the proceedings.

The proposed law contains provisions aimed toward the rehabilitation of enterprises in order to preserve jobs and maximize the return to creditors. It also permits the avoidance of certain transactions deemed detrimental to the estate and the recovery of unpaid assets as provided under the Dominican Civil Code.

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Despite a consensus concerning the need for a new legal approach to insolvency, there are still certain sectors that criticize specific provisions of the proposed law, such as those relative to the rights of secured creditors. The main reason behind such a position lies in the fact that the current legal regime applies solely to unsecured creditors, which in turn is the result of an approach aimed solely toward the liquidation of the debtor’s business. Under the existing regime, secured creditors—usually financial institutions—remain unaffected by the commencement of an insolvency proceeding for or against the debtor. The proposed law, however, contemplates the reorganization and rehabilitation of viable business enterprises, followed by liquidation if the debtor’s reorganization efforts fail. Accordingly, the proposed law requires secured creditors to participate in the reorganization process and will no longer permit them to pursue the enforcement of security interests in their collateral outside the insolvency proceedings, if such is considered

essential to the continuation of the debtor’s business during the reorganization proceedings.

The enforcement of security interests in the Dominican Republic has been characterized historically by the complexity of the enforcement procedures, severe time constraints and, in practice, an attempt by debtors and their attorneys to delay the enforcement proceedings under unprincipled or questionable grounds. Therefore, it is not surprising that the lending sector is skeptical of the new law and opposes participation in the reorganization proceedings to be pursued under the proposed law as it perceives the proposed statute as new fertile ground for defaulting debtors to further delay enforcement actions through the initiation of insolvency proceedings.

It will take a significant effort to create awareness among these key productive sectors of the Dominican Republic regarding the need for this law given the interrelation between business insolvency, financial crisis and the creditor rights system. Should the National Congress approve legislation that excludes secured creditors, the law would be ineffectual, as most security interests in the Dominican Republic are granted over assets that are essential to the business enterprise. The credit industry should focus its concerns on making sure that the new law includes adequate mechanisms to safeguard their interests and severely punish the initiation of bad-faith or frivolous insolvency proceedings. The application of the new law will require the development of a sustainable insolvency culture that would include the establishment of a strong specialized and predictable judiciary and an efficient and reliable panel of bankruptcy administrators. Enactment of the new law unquestionably would benefit the Dominican economy by promoting inbound foreign investment and cross-border business activities. ■

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