Peru

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Peru has experienced decades of sustainable economic growth. This growth has caused many Peruvian companies to implement debt and capital structures that are far more sophisticated and complex than in previous decades, as companies can now access financing from numerous sources without being limited to traditional lenders such as banks. For example, many Peruvian companies' liabilities include numerous debt instruments, such as bonds (issued both in Peru and abroad) and commercial paper, which are often regulated by foreign laws, negotiated exclusively with foreign entities or financed with local and foreign investment funds. This current trend in complex debt structuring is a departure from decades of past practice in which the vast majority of – mostly family-owned – Peruvian companies' liabilities generally included only passive bank debt and accounts payable to suppliers.

Similarly, the increasing sophistication of Peruvian companies' operations has led to the following two significant consequences: the formation of business conglomerates formed with Peruvian capital that have a presence in several countries; and the entry into Peru of foreign investment from a diverse range of countries.

Notwithstanding the decades of economic prosperity enjoyed by our country, the past five years have seen a stabilisation of the economy's growth rate, with rates much lower than the previous five-year period. This lower growth rate, coupled with a decline in the price of certain commodities essential to our economy (primarily metals), and external factors such as the reduction of hydrobiological fishing resources, has caused a considerable number of Peruvian companies and economic groups to experience solvency and liquidity problems.

Given the current economic situation, the establishment of adequate and efficient insolvency laws is imperative as these laws will decide essential issues for creditors in terms of recovering their capital and ultimately also control companies' survival in the market. Within the framework of these laws, and in the context of the internationalisation of Peruvian companies and economic groups, the current provisions regarding the recognition of, and compliance with, insolvency procedures concerning Peruvian companies or assets that are initiated and carried out abroad are of particular relevance in Peru.

Ultimately, laws governing cross-border insolvency will only be considered successful if they are predictable and allow creditors the best legal means possible for recovering their credits. Creditors should be able to know with certainty at the moment they extend credit which legislation and jurisdiction will support the repayment of that credit in the event of the debtor's insolvency, whether caused by external or internal factors. Having certainty over such information is vital, given that the solutions and approaches vary from country to country with regards to issues such as:

- the means of determining the viability of an insolvent company;
- whether to finance an insolvent company;
- how to finance an insolvent company; and
- how to distribute assets among creditors in the event of an insolvency.

These discrepancies in international regulatory regimes can prevent certain economic actors from quantifying the risk of granting credit ex ante and, therefore, the uncertainty derived therefrom will have an effect on the cost and availability of credit.

Thus, having a local insolvency regime that adequately addresses cross-border insolvencies will allow the Peruvian economy to, among other things: provide greater legal certainty for trade and investments; and adequately protect the debtor's assets and optimise its value, regardless of whether the debtor or its assets are located in Peru or abroad.

Given the current climate, the objective of this article is twofold. First, it will analyse current Peruvian legislation related to cross-border insolvencies. Second, it will present our point of view regarding current legislation and propose some adjustments based on the objectives mentioned in the preceding paragraphs.

Theoretical cross-border insolvency framework

In matters of insolvency, there are three broad conceptual theories that inform cross-border insolvency legislation: territoriality theory; universality theory; and mixed or intermediate theory.

In general, under the territoriality theory, if one debtor's assets are located in different countries that are not the debtor's domicile, the assets in each country should be subject to the laws of the country where the particular assets are located. In this scenario, the courts of competent jurisdiction of the country in which the property is located will have exclusive jurisdiction over the assets in situations where the debtor who owns the property becomes insolvent or ceases to make payments.

Under the territoriality theory, if a debtor enters into insolvency proceedings, the resolution of that process will apply only to the assets of the debtor that are located in the debtor's country of domicile. Accordingly, if a debtor has assets located in different countries, numerous insolvency proceedings will need to be initiated in each of these countries, with no one insolvency proceeding being considered superior or subordinate to the others.

Universality theory provides that, if there is a debtor who has assets located in countries other than that of the debtor's domicile, the law of a single jurisdiction must be selected as 'primary'. That jurisdiction will then have jurisdiction over the international insolvency proceedings in their entirety, regardless of the location of the debtor's assets.

Under universality theory, the jurisdictions of countries other than the primary jurisdiction must defer to the primary jurisdiction to determine the distribution of the debtor's assets located in their respective countries. As is evident, these 'secondary' jurisdictions play merely a supplemental role during insolvency proceedings, and the decisions made in the primary jurisdiction are final and binding in each country where the debtor's assets are located.

Finally, under the mixed or intermediate theory, a cross-border insolvency is resolved by the commencement of a principal proceeding, which is usually carried out in the jurisdiction where the debtor has its headquarters or principal domicile. However, pursuant to the mixed/intermediate theory, secondary proceedings are also commenced in all jurisdictions where the insolvent debtor has assets.

Under this theory, secondary proceedings are ancillary to the primary proceeding and are only initiated once the primary proceeding has commenced. The main function of the secondary proceedings is to ensure that the interests of creditors who are located in the jurisdictions of those secondary proceedings are adequately protected. The assets located in the jurisdiction of the secondary proceedings will be used to satisfy local creditors and, once the local debt has been satisfied with local assets, the residual amount (if any) will be remitted for satisfaction of the primary proceedings.

Current Peruvian legislation regarding cross-border insolvencies

Current Peruvian legislation embraces the use of secondary proceedings under the mixed or intermediate theory described above. In fact, Peruvian law directly addresses cross-border insolvency, providing that, in general, Peruvian insolvency commissions[1] are competent to rule on the insolvency of persons domiciled abroad, and that either the corresponding Peruvian judicial authorities have recognised the foreign judgment that declares the bankruptcy, or the Peruvian rules of Private International Law explicitly mandate so. However, regardless of the situation, it should be noted that the competence of Peruvian insolvency commissions applies exclusively to assets located in Peru.[2]

Additionally, Peruvian civil regulations complement the aforementioned laws by establishing that Peru has exclusive jurisdiction over assets located in Peru in actions concerning the estate of insolvent debtors.[3] Similarly, it is established that insolvency proceedings that begin in Peru but concern foreign insolvency are essentially administrative procedures for the liquidation of assets located in Peru. The debts of the local creditors will be cancelled using the funds from this liquidation, and if there are any funds remaining, they will be made available for the insolvency proceedings abroad.[4]

In addition, it should be noted that Peruvian law requires that the decision regarding the foreign insolvency proceedings must have been recognised in Peru by the relevant judicial authorities in order for the decision to be binding in Peru. Along those same lines, unless there is an international treaty with the foreign country regulating the specific issue, the Peruvian judicial authority must first obtain recognition of the foreign declaration by means of an exequatur, which in Peru is an extensive process and could take a significant amount of time.

Finally, in the aforementioned cases, even where creditors and the debtors come to an agreement regarding the forum for adjudicating the debtor's insolvency, if the forum is not Peru, this agreement will be invalid as debtors domiciled in Peru are governed exclusively by Peruvian insolvency rules. Thus, it is impossible for debtors domiciled in Peru to evade the jurisdiction of the Peruvian insolvency authorities.

Constructive criticism of the current model in Peru

We believe that the current system in Peru, which was created and developed over a decade ago, does not adequately regulate cross-border insolvency. Our position is that the current regime should be modified in the following ways:

- The current procedure for obtaining the recognition of foreign insolvency judgments is slow and cumbersome, and often causes significant delays. These delays are overly burdensome in the context of insolvency proceedings concerning international conglomerates with a presence in numerous countries. This in turn causes a delay in making important decisions regarding insolvency matters, such as avoiding an embargo or preventing the deterioration of the company and or its assets. On the other hand, timely responses from competent insolvency authorities can significantly benefit the development of the insolvent business and the collective recovery of creditors.
- Similarly, the fact that the current civil regulations state that the cross-border insolvency proceeding initiated in Peru is one of liquidation limits (in our opinion, in an exaggerated manner) the distribution of assets of the foreign debtor located in Peru. Indeed, it is possible that the mass of creditors from an insolvency proceeding decide that it is in all of their best interests to reorganise the debtor as opposed to liquidating, keeping the assets of the business operative, including those assets located in Peru, subject to the provisions and administration of a competent foreign court.

  We understand, however, that those regulations of Private International Law from Peru in the 1980s might have been the best alternative, given the limited amount of foreign investment in Peru and the protectionist sentiments in the country at that time. Additionally, the only insolvency law that existed when the current regime was created was bankruptcy law, which only allowed for a liquidation scenario. Thus, even within the Civil Code, the General Law of the Insolvency System currently in force in Peru does not adequately address those cross-border insolvency situations where bankruptcy is no longer the objective of the insolvency proceedings, but rather the creditors' recovery of the sums owed.

  Therefore, the current regulations regarding the recognition of foreign judgments to apply to the debtor's assets located in Peru would limit (unduly, in our view) how those assets could be distributed, even if the creditors of the insolvent business decided that their interests would be better protected by a restructuring than by liquidation. Accordingly, these provisions should, even when within the scope of the General Law of the Peruvian Bankruptcy System, be replaced by more modern regulations that allow for those creditors to meet with a company's board of directors to decide, for those assets located in Peru, what course of action is in the best interests of the creditors. This would offer greater flexibility and allow for a multitude of viable solutions regarding the liquidation of Peruvian assets.
- As mentioned above, in Peru, bankruptcy proceedings are administered and supervised by an administrative entity as opposed to judicial courts, as is the case in most other countries. However, the recognition of foreign insolvency judgments is done by the Judiciary. This means that, except in very limited circumstances, the procedure for recognising a foreign judgment of insolvency is evaluated and recognised, if applicable, by an entity (the Judiciary) that does not specialise or have any background in insolvency matters.

  Ultimately, the assessment made by the Judiciary for the recognition of foreign insolvency judgments is reduced to verifying whether the judgment meets the formal requirements mandated by Peruvian legislation for the judgment to have any effect in Peru, as opposed to an analysis of the judgment's merits. This aspect of cross-border insolvency law is consistent with the current status of the Peruvian regime for cross-border insolvencies, as the distribution of an insolvent debtor's assets is generally predetermined by law (liquidation of the assets located in Peru), regardless of the specific contents of the foreign judgment.

  Thus, we believe the ideal scenario would be for the same administrative entities that specialise in insolvency matters (Commissions of Insolvency Proceedings of the Institute for the Defence of Competition and Intellectual Property [INDECOPI]) to be responsible for the evaluation and recognition of foreign insolvency judgments, as long as Peru continues to have insolvency proceedings handled by these administrative entities. Under such an approach, we are confident INDECOPI would be able to expeditiously resolve requests for the recognition of foreign insolvency judgments and would be able to commence secondary insolvency proceedings in Peru almost immediately.

We are aware that implementing such a proposal would entail a vast array of significant changes at the legislative level, but we believe such changes would result in a much more efficient system and would employ more expertise in ruling on the recognition of foreign judgments on the merits of those judgments.

- Finally, we believe Peruvian legislation would benefit by adopting UNCITRAL's recommendations on cross-border insolvency, which would cause Peru to move from a regime inspired by a theory favouring secondary proceedings to a regime inspired by universalist theory. This would imply the application of a specific procedure for the Peruvian bankruptcy authority to designate certain insolvency proceedings carried out abroad as main proceedings, in cases where those proceedings comply with certain legally established requirements for acquiring main proceeding status.

In the above scenario, designating a foreign insolvency proceeding as a main proceeding would cause any decision issued in those proceedings to be final and binding with respect to the assets located in Peru, which is already the case in many other countries around the world.

We are also cognisant of the fact that such a change could even be considered an exclusion from the Peruvian insolvency rules with respect to the debtor's assets located in Peru. However, to the extent that the Peruvian authority recognises the proceeding as principal, foreign creditors have greater flexibility and certainty regarding the mechanisms for collecting on debts as long as the assets in Peru correspond to recorded property (not necessarily real property or equipment, but potentially shares representing the capital stock of a currently operating subsidiary located in Peru).

If Peru utilises a more standardised legislation in addressing complex cross-border insolvency rules that offer creditors better means of recovering on their claims, Peru will be positively impacted both in terms of the cost of credit, as well as by a surge of foreign investment in local companies.

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Notes

1 In Peru, bankruptcy proceedings are not judicial but administrative. Thus, when an insolvency is verified, the competent bodies that review and direct the insolvency proceeding are not Peruvian courts, but rather the procedural commissions of the Institute for the Defense of Competition and Intellectual Property (INDECOPI).

2 Article 6.2 of the General System of Bankruptcy Law of Peru (Ley General del Sistema Concursal del Perú).

3 Article 2061 of the Peruvian Civil Code (Código Civil del Perú).

4 Article 2105 of the Peruvian Civil Code (Código Civil del Perú).

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Established in 2004, Rebaza, Alcázar & De Las Casas is currently one of the top firms in the Peruvian market. The firm has built up a full service firm, adding to their premier transactional practice a number of highly specialized legal areas.

The restructuring and bankruptcy area of our firm has experience in private corporate reorganizations, bankruptcy proceedings and corporate liquidations, as well as in private restructurings and distress acquisitions (in and out of bankruptcy proceedings). Our firm has been involved in the most emblematic insolvency and restructuring transactions in Peru during the last decade.

The most prestigious international publications which analyse legal services (*Chambers and Partners*, *Latin Lawyer*, *Latin Counsel*, *Who's Who Legal*, *IFLR1000*, *Practical Law*, *GCLR 100*, among others) have acknowledged the high level of our team of lawyers. Such publications have consistently ranked our insolvency and restructuring practice as the leader in Peru in this field over the last years. Many lawyers of the insolvency and restructuring team are highly ranked by these publications as well.