

# El Salvador

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Located in the heart of Central America with a population of approximately 6.8 million, El Salvador is the most densely populated country in the Americas. Its legal framework is derived from the Constitution of 1983. El Salvador is a centralised state, with some political decentralisation deriving from the municipalities. The Constitution is the overriding legal text, followed by international treaties, laws and implementing regulations.

The legal system was originally based on the French civil code system. The Legislative Assembly enacts laws tabled by:

- the legislature;
- the president (through the ministers);
- the Supreme Court of Justice (on matters related to the judiciary, the courts' jurisdiction and the role of notaries public); and
- municipal councils (on matters related to municipal taxes).

The Peace Accords executed in 1992 introduced important amendments to the Constitution, focusing on the stabilisation of democracy and respect for human rights. The Constitution grants a number of individual rights, including freedom of contract, freedom of speech, private property, legal equality, the right to legal proceedings, free disposal of property and the right to resolve disputes through arbitration.

## **I. The legal framework and the effectiveness of court processes/legal remedies**

### ***1.1 Describe the nature and the effectiveness of the following:***

#### ***(a) Debt recovery remedies where the debtor has no security***

If a debtor has no security, the executor judge appointed by the court can seize movable property of the debtor and up to 20 per cent of the debtor's monthly salary. The court issues an order to the entity paying the debtor's salary requesting that it forward the agreed amount to the court. The executor judge can also seize the debtor's real estate property; however, such property is usually owned under a mortgage with third parties which have privileged rights over that property.

#### ***(b) The enforcement of security***

Security is enforced through asset and property seizure proceedings within the execution process. In these proceedings the court judge appoints an executor judge, who has the legal power to seize the debtor's assets. The most effective assets for seizure are real estate property. Seizure is carried out by filing a notice at the relevant real estate registry office. At that point the title to the property is frozen and cannot be transferred. Enforcement through seizure of movable goods is harder since the executory judge must obtain

proof that the debtor is the owner of the goods before seizing them. The easiest movable assets to seize are vehicles, as proof of ownership can be easily obtained from the government office responsible for registering all vehicles. Similarly, records pertaining to the registration of intellectual property are publicly available at another government office.

### **(c) Corporate bankruptcy/liquidation processes**

In El Salvador, real estate mortgages and pledges grant the creditor privileged rights to obtain payment from the assets given in guarantee ahead of third-party creditors without guarantees. Accordingly, bankruptcy proceedings are rare: in the last 20 years only two bankruptcy proceedings have been conducted. If a company becomes insolvent, usually individual creditors with preferred guarantees over specific assets (ie, real estate, accounts receivable or pledges over movable property such as machinery and equipment) file individual lawsuits based on their guarantees. Since the privileged guarantee entitles a creditor to be paid from the proceeds of the judicial auction of that guarantee before any other creditor, most unsecured creditors are aware that they would not obtain payment from the lawsuit of a secured creditor. Hence, most unsecured creditors will not join these lawsuits.

In addition, a creditor can ask the judge to appoint a receiver to the debtor. The receiver controls the debtor's cash flow to ensure that the corporation operates efficiently and pays the creditor out of incoming cash flow. As it is simpler to have the courts appoint a receiver, rather than going through bankruptcy proceedings before the courts, such proceedings are rarely used.

If creditors with specific guarantees over a corporation's assets feel that it is in their interests to allow the debtor to continue operations, rather than being paid directly through their guarantees, they usually negotiate out-of-court agreements to that end.

### **(d) Formal corporate rescue processes**

No corporate rescue process is formally established by law. Although there are similarities between the corporate rescue process set out by US Chapter 11 and the payment deferral procedure under Salvadoran law, the latter does not create a shield against claims for delinquent obligations of the debtor unless the main creditors voluntarily agree

to a corporate rescue plan.

In addition, even if the court has issued a declaration of payment deferral, creditors with guarantees over specific assets can force payment on those assets. Consequently, an insolvent debtor is subject to the will of the secured creditors and the law provides for no corporate rescue protection.

### **(e) Informal corporate rescue procedures**

The implementation of a corporate rescue process depends on the will of the secured creditors. Therefore, informal corporate rescue procedures are those negotiated by the parties.

#### **1.2 What are the formal processes to effect a liquidation of the company's assets?**

The formal processes to carry out a liquidation of the company's assets vary depending on whether the liquidation is voluntary or forced due to insolvency. If the liquidation is voluntary, the corporate shareholders meet to decide to dissolve the corporation and appoint a liquidator to conduct the liquidation process. A public deed of dissolution is granted and recorded at the Registry of Commerce. Once this deed is in force, the company's name is followed by the phrase "under liquidation". From that time only the liquidator can bind the debtor and execute any agreements on the debtor's behalf. It receives an inventory of all assets and disposes of every asset to pay the debtor's outstanding obligations, selling the rest to interested third parties. The proceeds of that sale are divided among the shareholders according to their equity participation. Once the liquidator has concluded the liquidation process, a public deed of liquidation is granted and recorded at the Registry of Commerce. A voluntary liquidation implies that the debtor's assets are sufficient to pay its debts; otherwise the voluntary liquidation becomes a bankruptcy procedure.

Alternatively, a formal liquidation process may be carried out when the debtor is insolvent. In such cases the liquidation is conducted through a judicial bankruptcy procedure. Once the judge has issued a bankruptcy declaration, he or she organises a creditors' meeting for all known creditors at which all issues regarding the liquidation (eg, credit preferences) are decided. The judge then issues a decision that includes all the agreements reached at the creditors' meeting and sets out the priority order for creditors. The judge then pays the creditors with the debtor's liquid

assets – creditors can even request that specific physical assets be given to them as payment. After this initial liquidation, if any assets remain and debts are still to be paid, the judge proceeds to auction the remaining assets and pay the remaining creditors with the proceeds.

However, as creditors with specific preferred guarantees can conduct separate lawsuits, the liquidation of a company's assets usually occurs through these individual lawsuits, with each creditor being paid by a specific guarantee. In each proceeding the judge auctions the specific assets given in guarantee (eg, real estate, machinery, equipment, rights with economic value) and the preferred creditor is paid first from the proceeds. If any money is left over, third-party unsecured creditors with no preference are paid proportionately. If the assets cannot be sold at auction, the judge gives the preferred creditor the unsold asset as payment of the claim.

**1.3 What is the effect on debt collection and the enforcement of security of:**

**(a) An adjudication of corporate bankruptcy/liquidation?**

According to Salvadoran law, all lawsuits filed against the debtor to claim payment are suspended and incorporated into the bankruptcy case, with the exception of lawsuits brought by creditors with preferred guarantees and alimony lawsuits.

**(b) The commencement of a formal corporate rescue process?**

Under the payment deferral procedure the judge can declare a suspension of payments. However, this does not affect secured creditors. Moreover, if the creditors reject the rescue plan, the proceeding automatically becomes a bankruptcy proceeding. Therefore, no real protection is given to a debtor attempting to implement a rescue through the payment deferral procedure.

**(c) The initiation of an informal corporate rescue process?**

Since an informal corporate rescue process is a voluntary attempt to negotiate payment of claims with creditors, the initiation of such a process has no legal effect on the company and its results depend on the negotiations between the parties.

**1.4 Are insolvency procedures started in another jurisdiction in respect of a corporation incorporated in your jurisdiction recognised? In particular, what would be the impact of the commencement of US bankruptcy proceedings?**

No – bankruptcy procedures for a corporation incorporated in El Salvador must be initiated in the national courts. In the case of US bankruptcy proceedings, these are not recognised until a specific decision issued by a judge in the United States is filed with the El Salvador Supreme Court for local enforcement. The simple initiation of a bankruptcy proceeding in the United States has no impact in El Salvador – specifically, payments will not be suspended unless a local bankruptcy proceeding is filed. Even in such cases, secured creditors are unaffected by any suspension of payments.

**1.5 In what circumstances would the directors or officers of a company in financial difficulties face potential liability for continuing to trade? In practice, are any such provisions actually enforced?**

Directors or officers face no responsibility or liability provided that they carry out only normal business activities until the court issues a declaration of bankruptcy. They must refrain from entering into fraudulent contracts with the objective of assigning the company's assets to third parties to the detriment of the original creditors. Moreover, once a declaration of bankruptcy has been issued in a local bankruptcy proceeding, the judge shall order the seizure of all the debtor's assets and shall appoint an administrator to take over administration of the debtor. Any action taken by directors or officers of the company after such a declaration shall be fraudulent and result in their liability.

**2. What are the advantages and disadvantages of triggering a formal insolvency or corporate rescue procedure?**

The advantage of a corporate rescue procedure is that the courts are not involved, while in a bankruptcy procedure the courts are involved and the right to manage the corporation is severely restricted. Consequently, a corporate rescue procedure may give the company time to negotiate its debts. However, the main disadvantage is that as the company starts to negotiate with debtors, creditors will realise that an insolvency situation exists within the company, which can make secured

creditors anxious to initiate individual lawsuits to assure the assets that guarantee their credits.

### **3. What are the practical options for out-of-court restructuring?**

As the agreement of secured creditors is necessary for corporate restructuring processes, most restructuring processes occur out of court. In El Salvador, most non-bank creditors with secured claims file individual lawsuits if their guarantees have a value higher than the balance of the loan. Usually banking institutions are the only entities that agree to the practical options produced by out-of-court restructurings; in most cases this is achieved through refinancing schemes. Under such schemes, the bank appoints a scheme supervisor to ensure that the arrangements agreed on in the refinancing scheme are implemented.

### **4. What is the effect on the management of a company of:**

#### **4.1 An adjudication of corporate bankruptcy/liquidation?**

An adjudication can lead to:

- a loss of administrative control by the owners;
- the appointment of new administrators by the court; and
- the initiation of a liquidation process.

Under Salvadoran bankruptcy law the final objective of bankruptcy proceedings is the payment of creditors, rather than the protection of the company. Consequently, the company continues operations only if this is in line with the creditors' interests.

#### **4.2 The commencement of a formal corporate rescue process?**

The nearest equivalent to a formal corporate rescue process under Salvadoran law is the payment deferral procedure. However, under such proceedings the company continues to carry out its own administration, unless the rescue plan is rejected by creditors, in which case the proceeding becomes a bankruptcy proceeding.

#### **4.3 The initiation of an informal corporate rescue process?**

The initiation of an informal corporate rescue process affects the management of the company

only in ways agreed by the parties. Since the informal rescue process is simply an attempt to negotiate with creditors out of court in order to implement a rescue plan, there are no legal effects on the management or administration of the company other than those agreed by the negotiating parties.

### **5. Parties in interest/key players**

#### **5.1 Who is responsible for the 'case management control and administration of a corporate bankruptcy/liquidation, a formal rescue and an informal rescue?'**

Once a judge has issued a bankruptcy declaration in a bankruptcy/liquidation, the administration of the debtor is granted to an interim supervisor appointed by the court, who exercises precautionary administration until the creditors' meeting with the judge. At that meeting all decisions regarding liquidation and payments are made. In an informal rescue process the parties agree to resolve those issues as they see fit.

#### **5.2 Who is responsible for preparing the restructuring plan in a formal or informal rescue?**

In the payment deferral procedure the company prepares a restructuring plan and submits it to the creditors. In an informal rescue the plan is prepared according to the agreement between the parties.

#### **5.3 Who are the key players? What are their roles and responsibilities?**

In the payment deferral procedure the key players are the judge, the debtor and the creditors. The judge can issue a payment deferral decision even after creditors have been given notice. Once such a decision has been issued:

- all credit payments are suspended (except secured and alimony creditors);
- the judge appoints an administrator for the company; and
- the decision is published so that creditors can appear before the judge to discuss the restructuring plan proposed by the company.

If the proposed restructuring plan is not agreed before the judge, the creditors and the company, the company is declared bankrupt and bankruptcy proceedings are initiated. If agreement is reached, the creditors may appoint an interim supervisor to

oversee implementation by the court-appointed administrator.

As informal rescue processes are not regulated by Salvadoran law and are simply a way for the company to negotiate with its creditors out of court, the key players in such process are the company, which negotiates the terms of a restructuring plan, and the secured creditors. Acceptance of the plan by the secured creditors is essential as they can file individual lawsuits in regard to specific assets that could be vital to company operations.

## **6. What financial information is available to creditors?**

In the payment deferral procedure all the company's financial information shall be available to creditors once the payment deferral decision has been issued.

As there are no applicable regulations for an informal rescue process, the information available to creditors depends on the company. If a judge does not issue a payment deferral decision or a declaration of bankruptcy, the company need not make financial information available to creditors.

## **7. Common questions**

### **7.1 Funding and the priority given to new money**

**(a) If an insolvent corporation requires urgent working capital funding, what difficulties are likely to be encountered in the provision of such funding?**

There are no restrictions on providing funding to the company, as long as such funding does not require the creation of new guarantees. Secured creditors maintain their preference rights on existing guarantees. If the preferred secured creditor is a bank, the company cannot grant new securities on the real estate over which a bank has mortgage rights without the bank's consent. However, if new funds are used to restructure the company's banking debt, such funds are likely to be used to pay the bank and secured creditors.

**(b) Are lenders providing new money or debtor-in-possession financing given any statutory priority?**

El Salvador does not regulate this type of financing. Creditors that have secured their loans with mortgages or pledges have the right to be paid first from the proceeds of the judicial auction of assets given as guarantees, without being affected by the

suspension of payment implemented by a bankruptcy declaration. Consequently, new money or debtor-in-possession financing has the same priority as other unsecured creditors – that is, such debts will be paid proportionately with other unsecured creditors after secured creditors have been paid.

### **7.2 Ranking of creditors**

**(a) In what order are creditors paid in a corporate bankruptcy/liquidation?**

Salaries, holiday payments, bonuses or benefits owed to employees are paid first. Secured creditors are paid next and finally the remaining creditors are paid proportionately with the leftover funds.

### **7.3 Avoidance of antecedent transactions**

**(a) Are there any legal provisions that might operate to invalidate the creation of security, the disposal of an asset or the payment of a creditor by a company in financial difficulties?**

General provisions exist on the annulment of transactions that create securities or dispose of assets when a company is in financial difficulties. However, if the action is filed before the judge has issued a bankruptcy decision, the law requires proof that the company was in financial difficulties and that both parties to the transaction were aware of these difficulties and acted in bad faith. Due to the difficulty involved in providing such proof, this legal action is rarely used. However, the annulment of a transaction that occurs after the judge has declared bankruptcy requires only proof that the transaction occurred after the declaration was issued.

### **7.4 'Cram-downs'**

**(a) What is the position of both unsecured and secured creditors that vote against, do not agree with or do not consent to either a formal or informal rescue plan?**

Secured creditors can simply not agree to the rescue plan and file lawsuits based on their specific guarantees with no other legal effect. Unsecured creditors may or may not agree, but this decision has no legal consequences for them. Neither secured nor unsecured creditors are obliged to agree a formal or informal rescue plan.

### **7.5 Creditor protection**

**(a) What action can creditors take if they are not satisfied with the conduct of either a formal rescue procedure or a corporate bankruptcy/liquidation?**

As bankruptcy proceedings are conducted before a judge, if creditors are not happy with the judge's decisions they have the right to complain in the proceedings or to appeal under the law.

As the payment deferral procedure is also conducted before a judge, creditors may also complain in the proceedings or appeal under the law.

Creditor protection in an informal rescue

process depends on whether the unsatisfactory conduct occurred before or after the restructuring plan was agreed. If it occurred before the agreement, creditors can file individual lawsuits or request the judge to declare bankruptcy. If it occurred after the agreement, creditors must abide by the terms of the plan to which they have agreed. However, in practice, restructuring plans include clauses that allow creditors to file suit immediately on detection of any misconduct by the company.

In addition, secured creditors can always reject a bankruptcy, a payment deferral procedure or a restructuring plan and instigate separate lawsuits to seek payment from the proceeds of the judicial auction of guarantees.