

# Costa Rica

Humberto Pacheco,  
senior partner  
Andrea Hulbert,  
senior associate  
**Pacheco Coto**

Costa Rica is a democratic, free and independent republic whose legal framework comes from the Roman-German tradition – that is, a civil law system.

This chapter provides a general explanation of the applicable legal system in Costa Rica in regard to the collection of secured or unsecured debts, bankruptcy and corporate liquidation, as well as formal and informal proceedings for corporate recovery. The type of proceeding depends on the nature of the obligations in default.

Explanations relating to debt collection are based on the provisions of the newly enacted Judicial Debt Collection Law (8624), which is effective as of May 20 2008.

## **1. 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**

'Unsecured debt' is debt that is not supported by specific assets such as mortgages or chattel mortgages (secured transactions) or by execution documents, such as cheques, bills of exchange or promissory notes (negotiable instruments).

The available court proceedings designed to recover unsecured debts are:

- the *monitorio* process;
- advanced civil confession; and
- the ordinary process.

In all such proceedings, if the creditor wishes to secure debt collection it must file a request for a pre-judgment attachment and provide a guarantee deposit of 25 per cent of the amount of the requested attachment.

**Monitorio process:** The collection of payable monetary obligations based on documents with no executory force can be handled through the *monitorio* process.

The base document must either be an original, executed, certified copy if the law so allows, or be contained in a physical context wherein the identity of the debtor is unquestionable as identified by the debtor's signature, the signature of two instrumental witnesses or any other equivalent proof.

Once the lawsuit is admitted, the judge will issue an advanced ruling instructing the debtor to settle the requested amounts of principal, liquidated interest, future interest and any and all court costs within 15 days, or to oppose the ruling by filing any applicable defences.

In the event that the debtor does not oppose the advanced ruling, or does not file a timely response, or in the event that the opposition is groundless,

the ruling will be executed immediately by auctioning the relevant assets.

In the event that the opposition is well founded by means of procedural or material defences based on useful evidence, the judge will call for an oral hearing wherein conciliation will first be attempted; if this process fails, the parties will discuss the filed defences, the evidence and their conclusions. Immediately thereafter and at the same hearing, the judge will issue the ruling. This ruling is subject to appeal.

Once the sentence becomes final, the attached assets will be auctioned according to the judge's order.

**Advanced civil confession:** If the creditor is entitled to accounts receivable (due and payable) but lacks a document supporting it, or if such document does not comply with the requirements set forth by law, the debtor may resort to an advanced civil confession proceeding. This proceeding is a preparatory step towards a *monitorio* or ordinary process.

The proceeding starts at the request of the creditor, which asks the judge to call the debtor to confession under oath, the purpose being for the debtor to acknowledge the existence of the debt and the amount of principal and interest owed.

If, during the confession, the debtor acknowledges the existence of the debt and its amount, the confession leads to an execution document, which is collectable through a *monitorio* proceeding. This allows the creditor to start the proceedings and to enjoy an accelerated process and a pre-judgment attachment without the need for a guarantee deposit.

**Ordinary process:** If the debtor does not accept the existence of a due and payable obligation, the creditor must resort to an ordinary process. This proceeding is a declaratory proceeding resolving situations relative to law and rights. It is a formal proceeding and is therefore lengthy. It allows for the participation of the parties and ends with a ruling that is final and binding.

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

A 'secured transaction' is an obligation supported by securities *in rem*, such as mortgages or chattel mortgages, or by personal guarantees such as bills of exchange and promissory notes, which may be executed on property by means of summary proceedings, known as proceedings with executory force.

The law gives certain documents executory force, whereby the creditor is entitled to attach the debtor's assets without the need for a guarantee deposit as under a pre-judgment attachment.

The newly enacted Judicial Debt Collection Law sets out the following procedures to collect obligations supported by guarantees.

**Ejecución process:** Common mortgages and bonds guaranteed by a mortgage, as well as duly recorded chattel mortgages, are executory instruments designed to safeguard the priority claim over those mortgaged assets or, when applicable, the amount of insurance thereon, and to secure all personal guarantees limited to any outstanding balance thereof.

Once the lawsuit has been admitted, the judge will serve notice on the debtor and, when applicable, on the registered owner of the mortgaged assets who granted the lien.

The defendant may oppose the lawsuit by alleging lack of cause for execution of the obligation, its timely payment or the expiry of the statute of limitations. In this case, the judge will order an oral hearing where a conciliation process will be attempted; failing this, the parties will discuss the filed defences, the evidence and their conclusions, and the judge will issue a ruling. The ruling is subject to appeal.

Once the ruling becomes final, the court will order the public auction of the assets.

**Monitorio process:** Within the context of the collection of secured debts, collections of due monetary obligations based on public or private documents having executory force are handled through this procedure.

The structure of the procedure is the same as stated in section 1.1(a) above, the only difference being that the instrument with executory force allows the issuance of an attachment order without the need for a guarantee deposit.

As a result of the final ruling ordering payment of the debt, the court will proceed to the payment of the monies owed to the creditor which were previously attached and/or to the auctioning of the debtor's assets.

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

The liquidation of a company's assets may be through a compulsory bankruptcy proceeding or through a voluntary liquidation procedure approved by the shareholders.

**Company bankruptcy proceedings:** Bankruptcy is a statutory procedure by which a debtor undergoes a judicially supervised liquidation of its assets for the benefit of its creditors. The procedure is carried out against a businessperson or a company as a result of non-compliance with obligations which leads to the suspension of payments to creditors.

A judgment of bankruptcy issued by a court of law is available in the following circumstances:

- at the debtor's request due to its inability to honour its indebtedness and in the hope that each creditor will receive at least part of its claim;
- when a creditor becomes aware that two or more collection proceedings have been filed and are pending against the debtor as a result of different secured debts or by different creditors, where there is awareness that the debtor has insufficient assets to pay off its debts;
- when a creditor discovers that the businessperson or commercial entity has ceased payments of obligations and debts;
- when a debtor hides or abandons the business without appointing another party with adequate powers of attorney and instructions and without sufficient funds to oversee the company and comply with its obligations;
- when a businessperson unjustifiably shuts down business establishment;
- when a debtor transfers or assigns all of its assets for the benefit of one or more of its creditors; or
- upon evidence of fraud or deception by the company in order not to honour its debts.

A bankruptcy ruling requires the existence of several creditors and evidence that the debtor lacks sufficient assets to satisfy all of its indebtedness, thus establishing an irreversible and serious state of insolvency which impedes its economic recovery.

With the purpose of securing the assets of the debtor, the Commercial Code provides for a look-back period during which the effect of the bankruptcy is backdated for a period of three to six months prior to the date of filing.

The judge will order a complete takeover of the management of the company and the disposition of the assets of the insolvent party. Creditors are not legally allowed to request attachment of the assets of the debtor; all such creditors must become parties within the bankruptcy proceeding in order to collect their claims. A fair settlement of all debts is thereby guaranteed to creditors pursuant to their corresponding percentages regarding the amount of their claims and any privileges to which they may be entitled under the relevant credit instruments.

A bankruptcy trustee is then appointed, This administrator is responsible for the management of the debtor's assets and holds general powers of attorney on behalf of the debtor.

The creditors' meeting is the highest-ranking mechanism in a bankruptcy; most key decisions are taken by majority vote at the meeting.

Payments to creditors are carried out equitably after the liquidation of all of the debtor's estate. Privileged creditors holding mortgage and chattel mortgage instruments collect first, pursuant to the corresponding guarantee. Ordinary creditors are entitled to payments as defined by the trustee and the judge. Such amounts are established pursuant to the availability of any remaining assets, the number of creditors and the amount of the respective claims.

Bankruptcy proceedings end upon payment of the claims or a ratio thereof, or upon agreement of the creditors.

**Corporate dissolution and liquidation processes:**

Commercial companies may be dissolved for any of the following reasons:

- termination of the term provided for in the articles of incorporation;
- inability to pursue the business purpose of the company;
- definitive loss of 50 per cent of the company's share capital, except in the event that the shareholders replace the capital loss or agree to reduce the capital proportionally; or
- resolution of the shareholders.

Once the company has been dissolved it will enter a liquidation process, which will be handled by one or more liquidators who act as administrators and legal representatives of the company.

The liquidation will be carried out pursuant to the provisions of the incorporation documents. Failing that, the liquidation will be handled pursuant to the vote of the majority of the shareholders as statutorily required to amend the company statutes.

The appointment of liquidators will take place pursuant to the provisions of the incorporation charter. If the charter makes no such provision, such appointment will be carried out based on the agreement of the shareholders at the same time as the decision to dissolve the company. If agreement is not reached, the appointment will be made by a judge at the request of an interested party.

The administrators must deliver all assets, corporate records and documents pertaining to the company to the liquidators pursuant to an inventory.

The liquidators have several functions:

- termination of any pending operations of the company;
- gathering and assessment of claims and fulfilment of the company's obligations;
- sale of the company's assets at the authorised prices following the rules of the liquidation process;
- preparation of the final liquidation statement and submission thereof to discussion and approval by shareholders; and
- delivery to each shareholder of corresponding portion of company property.

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

There are two formal corporate rescue processes in Costa Rica: judicial administration and reorganisation, and a preventive agreement.

**Judicial administration and reorganisation:** This procedure is aimed at restructuring the company and involves an intervention and a reorganisation plan by which the company can be rescued.

Any businessperson or company going through a difficult financial situation, with or without the suspension of payments, may use this procedure as long the business is still viable provided that:

- a bankruptcy proceeding or an assembly of creditors has not yet been declared; and
- a preventive agreement is not underway.

The judge will order judicial administration if the disruption or disappearance of the company may cause negative social effects. With that in mind, the judge will consider the number of employees that may lose their jobs, the suppliers and creditors which will be affected and the clients to which the endangered company is a supplier.

The process can be initiated pursuant to a request submitted by the debtor, the creditors or the General Superintendence of Securities, in the case of companies authorised to issue public securities.

The petition must provide an explanation of the events causing the financial crisis and the steps deemed necessary to overcome such crisis. In addition, it must be accompanied by tax returns, statements of assets and liabilities and an intervention and reorganisation plan prepared by an expert in administration or finances. Such a plan may provide for the controlled management of the company, the suspension of payments and reorganisation measures such as a capital increase, the capitalisation of claims,

the assignment of the company or its merger with another company or companies.

Where feasible, the judge will order the initiation of judicial administration and will appoint an *interventor* and a supervisory committee of advisers and inspectors representative of the creditors and the employees.

The remedy plan will be submitted for the approval of the creditors, the *interventor* and the supervisory committee. The judge must issue a resolution on the proposed plan. If the plan is not viable, the judge will order the liquidation of the company. If viable, the judge will approve it with any and all necessary corrections.

The remedy process must be executed by those responsible for the management of the company with the supervision of the auditor and of the supervisory committee, under the direction of the court.

The execution of the remedy process may last up to three years, except when 75 per cent or more of the creditors decide otherwise by accepting a longer term to the process.

The most common causes for termination of the process are the recovery of the company, the expiration of the term or the failure to fulfil the plan.

**Preventive agreement:** A debtor undergoing an economic or financial crisis may submit a preventive agreement proposal to its creditors. However, such a debtor must not:

- already be declared bankrupt;
- be subject to a creditors' meeting; and/or
- be going through a judicial administration and reorganisation process.

The petition must contain a description of the facts causing the financial crisis affecting the debtor, the type of agreement being proposed and its details.

If the judge finds the request admissible, he or she will:

- declare the initiation of the process;
- appoint an administrator or trustee;
- summon the creditors and register their claims; and
- issue whichever precautionary measures he deems fit.

The admission of such an agreement will prevent any individual actions against the debtor's assets.

The trustee will submit an opinion regarding the feasibility of the proposed agreement and the debtor's circumstances. Thereafter, the court will summon the creditors to a meeting with the purpose of discussing and voting on the proposed agreement.

The agreement may be approved by a majority of creditors present, representing at least two-thirds of all registered claims. Immediately thereafter, the court will approve or reject the agreement.

If the court approves the agreement, it will specify the necessary steps for its compliance.

If the court rejects the agreement, it will immediately order bankruptcy proceedings to be initiated against the debtor.

The agreement may be terminated if the debtor does not grant the promised guarantees or has failed to comply with the obligations set out in the agreement.

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

The vast majority of corporate recovery processes are dealt with out of court due to the flexibility of the accords and the speed of the decision-making process, and because this minimises negative publicity.

There are many recovery options, depending on the particular circumstances of each case. The debtor and its creditors may agree to solutions such as:

- the voluntary delivery of assets in lieu of payment;
- extended terms;
- conversion of existing debt into new obligations or capital;
- creation of trusts; and /or
- new reorganisation or recovery measures.

In some cases creditors have set up committees and actively participate in the decision-making processes of the company.

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

The formal liquidation of the debtor's assets is carried out through a commercial bankruptcy proceeding or a corporate liquidation process (see section 1.1(c)).

The liquidation of assets may also be carried out under the terms of a preventive agreement.

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

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

The bankruptcy ruling crystallises the creditors' position while halting the accrual of current or delayed interest due to creditors, and triggers the

maturity date of all pending obligations and the right to demand compliance with all the debtor's commitments. Ordinary creditors will be paid on a *pro rata* basis, regardless of dates.

Claims are classified in the following order for purposes of payment:

- privileged claims secured against a given asset;
- employees' claims;
- lessors' and lessees' claims; and
- ordinary claims (see also section 7.2).

All creditors except secured creditors must legalise their claims before the judge.

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

When a judicial administration and reorganisation proceeding is initiated, it has the following effects on the collection of debts:

- All debt collection actions are suspended with the purpose of maintaining the productivity of the company;
- Payments set forth in the rescue plan are suspended until approval is granted; and
- Interest is reduced temporarily to the basic passive rate established by the Central Bank of Costa Rica for obligations denominated in colones and to the international prime rate for debts in US dollars.

Interest not paid at this time will be accrued and added to the principal obligation, although it does not generate new interest itself and will be settled only once the company reaches a more stable economic situation.

Once the plan is finally approved, these measures can be replaced to allow the adjustment of interest as deemed adequate pursuant to an expert study. However, interest not yet settled will be paid only once the company reaches a better economic situation. The plan will be binding on all creditors existing prior to the start of the proceedings, except for labour or sustenance claims and those holding rights *in rem* – that is, mortgage and chattel mortgage creditors with lawsuits not affected by the proceeding, up to the amount covered by the encumbered assets.

Debts will be paid to creditors directly pursuant to the terms provided in the approved plan, which must respect all priorities granted by law to certain privileged creditors. The plan may maintain the interest payment adjustments.

In the case of a preventive agreement, all debt

collection actions are also suspended.

Obligations will be settled in accordance with the approved preventive agreement.

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

When the creditors and the debtor agree to commence informal corporate recovery proceedings, they must anticipate the possible situations relative to debt collection and the foreclosure of guarantees. Otherwise, such situations will be handled by the court.

The parties must take measures to define the rearrangement of debts, the extension of terms of pending obligations and the renegotiation of securities.

**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 US bankruptcy proceedings being commenced?**

A bankruptcy ruling issued abroad cannot be invoked against local creditors to dispute the rights they are pursuing or to annul any agreements between those creditors and the debtor.

Local assets owned by a debtor declared bankrupt or facing a group of creditors in another jurisdiction will be executed by local creditors. Only after local claims have been satisfied can foreign creditors collect any remaining monies.

Consequently, when a bankruptcy ruling exequatur is received from abroad, the local court will commence bankruptcy proceedings to satisfy local creditors; once these are satisfied, the court will remand the remaining assets to the foreign court.

**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?**

Legal representatives of companies which continue to trade when under bankruptcy restrictions are subject to liabilities imposed by the law or executed contracts and liabilities resulting from potential criminal actions they could incur. Such representatives are compelled to comply with the duties defined by the law and by the articles of incorporation relative to creditors, stockholders and third parties.

Such liabilities are enforced by the courts.

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

Formal proceedings preserve the assets and the final distribution of those assets. In addition, there is the possibility of annulling acts that may have affected the debtor's estate.

The major disadvantage is the slow pace and formalities of the court procedure. In addition, the law can be inflexible and a court case can lead to high costs and negative publicity.

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

The out-of-court restructuring procedure will depend on the company's own needs and those of its creditors. There is no uniform formula for such events. The use of a trust to restructure and unify indebtedness is probably one of the most common vehicles.

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

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

Upon the issuance of a bankruptcy ruling, the legal powers of the directors and officers of a company cease. The judge orders the full takeover of the management of the company and the disposal of the company's assets – as of that moment, the bankruptcy trustee is in charge of the administration of the company.

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

**Judicial intervention and reorganisation process:** Once a judicial intervention and reorganisation procedure has begun, two possible scenarios may occur in regard to the management of the company.

First, the judge may order the cancellation of all powers of attorney of the company, the removal of all officers and directors and the appointment of a provisional general manager. This applies when there is evidence that the financial crisis is the result of unauthorised actions by the management, either in bad faith or in breach of the law or the company's articles of incorporation.

Alternatively, the administration may continue in the hands of the bodies provided in the articles of

incorporation, which may take actions only as necessary to ensure the company's normal trading activity. In addition, these bodies will require the authorisation of the judge for:

- the transfer of real estate or movable assets that are not part of the company's trade;
- the assignment, exchange or granting of leases on real estate owned by the company; or
- actions that may further commit the company's financial resources.

Once the judicial intervention and reorganisation programme has been approved, it will be executed by management according to the terms of the plan under the supervision of the interventor and other members of the advisory committee, under the direction and supervision of the court.

**Preventive agreement:** When a preventive agreement to assign assets to creditors is approved, the judge will appoint two or more creditors to become members of a committee headed by the trustee in order to liquidate the assets and distribute the resulting proceeds.

If a dilatory agreement is approved, it will be executed by management according to its terms under the compulsory supervision of the trustee and other members of the advisory committee, under the direction and supervision of the court. The court will order any necessary measures to secure compliance with the agreement.

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

The effect on management of a corporate rescue process depends on the agreement reached by the 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?**

In the event of bankruptcy, the trustee is responsible for the management and control of the process.

In a corporate liquidation, in accordance with the statutes and the corresponding legal provisions, the liquidator is responsible.

In the event of a judicial administration and reorganisation, the *interventor* is responsible.

In a preventive agreement, the trustee is responsible.

Informal agreements are under the responsibility of the person appointed by the signatory parties.

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

In a judicial administration and reorganisation the company is usually responsible for preparing the applicable recovery plan.

The preventive agreement is proposed by the debtor.

In regard to informal agreements, the responsibility lies with the person appointed by the interested parties.

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

**Bankruptcy proceeding:** The debtor is responsible for requesting the commencement of bankruptcy proceedings and submitting to the judge's instructions. When bankruptcy is requested by the creditors, the debtor must respond to the request and provide the court and the trustee with the required information.

The creditors may request the bankruptcy proceedings; they are responsible for registering their claims and commencement and voting in the creditors' meeting.

The bankruptcy trustee is responsible for the management of the company and has general powers of attorney. He or she is responsible, among other things, for:

- preparing the inventory of assets;
- gathering and assessing all claims in the bankruptcy, either in court or through out-of-court proceedings;
- recovering assets held by third parties;
- continuing any pending lawsuits that may be worth pursuing;
- informing the judge about all claims;
- selling the assets pursuant to an appraisal;
- preparing the distribution plan; and
- paying off creditors.

**Judicial administration and reorganisation procedure:** The debtor is responsible for requesting the commencement of formal recovery proceedings, proposing the rescue plan and providing the judge and the *interventor* with all required information.

The creditors may request the commencement of the proceedings. They are responsible for registering their claims and voting on all decisions taken by the creditors' meeting.

The *interventor* is responsible for:

- verifying the information provided by the representatives of the company;
- examining and submitting observations on the administration plan;
- verifying the list of creditors and providing an opinion on the claims filed; and
- supervising the execution of the plan.

**Preventive agreement:** The debtor is responsible for proposing the agreement.

The creditors are responsible for registering their claims and approving the agreement by majority vote.

The trustee must issue its opinion on the feasibility of the agreement and on the status of the debtor.

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

During the course of the bankruptcy proceeding, the trustee has access to all of the company's accounting and financial information. As parties to the proceedings, creditors have access to all information filed in court by the trustee.

The same applies to the *interventor* in the case of judicial administration and to the trustee with respect to the preventive agreement.

## **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?**

Such difficulties will be contingent on the credit policies of the state and private banking institutions according to the company's commercial activity.

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

The possibility of obtaining a new loan will depend on the credit policies of banks and investors. There is no legal priority for such financial assistance. The new creditor becomes subject to the legal rules of the order of preference.

### **7.2 Ranking of creditors**

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

Claims are classified as follows:

- privileged claims secured on a given asset;
- employees' claims;
- lessors' and lessees' claims; and
- ordinary claims.

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

**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?**

In order to protect the assets of the insolvent, Section 868 of the Commercial Code provides for a look-back period during which the effects of the commencement of bankruptcy proceedings become retroactive for a period of between three and six months.

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

**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?**

Creditors must abide by the decisions of the majority and those of the judge, and have recourse against creditors' agreements and court rulings when their rights and interests are or may be in jeopardy.

Rules within informal recovery procedures are set forth by majority decision of the parties.

### **7.5 Creditor protection**

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

See sections 1.1(c) and 1.1(d) above.

Unsatisfied creditors may exercise a number of recourses against agreements and rulings. Nonetheless, ultimately they must abide by the rules of the procedure and by the decisions of the majority.