

# New cause for dissolution for non-compliance with the requirements of an ongoing business

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The following are some considerations on the new cause for dissolution due to non-compliance with the requirements of an ongoing business (ROB), its suspension and the continuity of the cause for dissolution due to losses as a consequence of the provisions set forth in the companies' bylaws.

## A. Verification of the occurrence of the cause for dissolution due to non-compliance with the ROB

Before to the issuance of Law 2069 of 2020 (Entrepreneurship Law), the Commercial Code established the cause for dissolution due to losses consisting in the decrease of the net equity below 50% of the subscribed capital.

The Entrepreneurship Law replaced the above cause with a new one based on the non-compliance with the requirements of an ongoing business. This new cause is not limited to an objective evaluation of the comparison between equity and capital, as was the case with the cause for losses, but implies that the administrators must carry an analysis of the financial and operational situation of the company. According to the Superintendence of Companies (Opinion 220-016853 of February 24, 2021), the management must consider the current facts and project into the future of the company at least 12 months, but not limited to this time, starting from the closing of the fiscal year. The criteria mentioned by the Superintendence of Companies include: (i) negative cash flows; (ii) difficulty in accessing bank loans in the short term; (ii) renegotiation or restructuring of credits; (iii) failure to pay creditors; (iv) shortage of essential supplies for the operation, among others.

In regards to the evaluation of the compliance with the requirements of an ongoing business, the Superintendence of Companies, by means of Opinion 220-034919 of March 28, 2021, indicated that according to numeral 15 of Decree 2101 of 2016, the companies may be under the following scenarios: a) There are no significant uncertainties related to events or conditions that may generate significant doubts about of the entity's ability to continue as an ongoing business, but the management has made the decision to liquidate the entity and the value of its assets or liabilities has been significantly affected. It is in this scenario, when this provision should be applied. b) There are significant uncertainties related to events and conditions that may raise significant doubts about the entity's ability to continue as an ongoing business, but the assumption of ongoing business hypothesis remains appropriate. c) The ongoing business assumption is not appropriate because the entity has no real alternatives other than to terminate its operations or liquidate. It is in this scenario, when this provision should be applied.

The Superintendence, also stated that the companies that do not comply with the requirements of the ongoing business will not be admitted in the reorganization proceeding set forth in Law 1116 of 2016 or to the "Emergency negotiation of reorganization agreements", nor to the "Abbreviated reorganization proceeding for small insolvencies", provided in Legislative Decrees 560 and 772, respectively.

In broad terms, according to the Superintendence of Companies, when conducting the verification of the ROB it is necessary to analyze whether the financial situation of the company results in an imminent liquidation as no alternative can be found in order to continue with the operation of the company. This cause will also take place when there is intent to liquidate and close operations, but in the words of the Superintendence of Companies (Opinion 220-033879 of March 06, 2018) when quoting concept 115-243594 of December 14, 2016 of the Accounting Research and Regulation Group, "the sole intention to liquidate in the future is not enough to not comply with the ongoing business principle".

A draft decree is being prepared by the Ministry of Industry and Commerce to regulate, among other matters, the moment in which the occurrence of the ROB must be verified and the financial reasons or criteria to establish equity impairment and insolvency risks, given that the Entrepreneurship Law states that the regulations could establish the financial reasons or criteria to set the cause.

#### **B. Review and amendment of the company's bylaws regarding cause for dissolution**

According to numeral 5 of article 218 and numeral 1 of article 457 of the Code of Commerce which refers to the causes set forth in Article 218 of the Code of Commerce, companies are also dissolved for the causes expressly and clearly stipulated in the bylaws. The same takes place in simplified joint stock companies (SAS) by means of the contractual autonomy provided for in Law 1258 of 2008. Therefore, if the bylaws state that the company will be dissolved due to losses that reduce the equity below 50% of the subscribed capital, it may be interpreted that the cause for losses still applies. To that extent and with the purpose of avoiding any discussion on this regard, we suggest amending the bylaws to eliminate such dissolution cause.

#### **C. Effects of the occurrence of the new cause for dissolution**

When the occurrence of the new cause for dissolution can be reasonably verified, the administrators must (i) refrain from initiating new operations, other than those of the ordinary course of business; and (ii) immediately summon the Shareholders' Assembly or the Board of Directors to fully inform and document said situation. The foregoing so that this corporate body takes the corresponding decisions regarding the continuity or dissolution and liquidation of the company.

The administrators must also summon the Shareholders' Assembly or the Board of Directors when from the analysis of the financial statements and projections of the company it can be established that there are equity impairments and risks of insolvency. We expect the regulatory decree to refer to the financial statements on which the cause must be established, since the Entrepreneurship Law did not specify it.

In the event that the administrators do not summon the Shareholders' Assembly or the Board of Directors in those cases, they will be jointly and severally liable for the damages caused to the shareholders or third parties.

#### **D. Suspension of the cause for non-compliance with the ROB**

Due to the sanitary emergency cause by COVID-19, the National Government issued Decree Law 560 of April 15, 2020 and thereafter Decree 722 of June 3, 2020, in which, among other matters, the configuration of the cause for dissolution due to losses set forth in the Commercial Code, as well as the term to remedy the cause (Article 24 of Law 1429 of 2010 and Article 35 of Law 1258 of 2008) were suspended. Although the Entrepreneurship Law did not specifically refer to the suspension of the new cause (ROB), it did state that the references made in any regulation related to the cause of dissolution due to losses shall be understood as referring to the new cause. For the same reason, and as concluded by the Superintendence of Companies in Concept 220-16853, issued on February 24, 2021, the cause for non-compliance with the requirements of an ongoing business is suspended until April 16, 2022.

#### **E. Deadline to adopt measures aimed to remedy the cause for non-compliance with the ROB**

The Entrepreneurship Law does not establish the term to remedy the new dissolution cause after its occurrence. This Law, however, indicates that the relevant corporate body must take the relevant decisions regarding the continuity or the dissolution and liquidation of the company. To the extent that the dissolution due this cause requires declaration of the corporate body, we consider that it is necessary to apply the 18-month term set in Article 24 of Law 1429 of 2010 and in Article 35 of Lay 1258 of 2002 since, as mentioned above, the Entrepreneurship Law states that the references to the cause of dissolution due to losses must be understood as referring to this new cause.

Nevertheless, due to the suspension of the term to remedy this cause, it must be understood that the 18-month term will apply as of April 16, 2022.

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