7. Insolvency: Reorganization and Bankruptcy proceedings

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There are fundamental differences between reorganization and bankruptcy. Reorganization allows the debtor to continue operating and to maintain its existence while attempting to rehabilitate its financial situation. Bankruptcy, on the other hand, refers to the liquidation of assets. In a bankruptcy context, the insolvent debtor must liquidate and distribute company assets to satisfy creditors' claims. Another significant distinction is that only the debtor (either a legal or natural person) may request reorganization, while a bankruptcy case may be opened upon request of either a debtor or its creditors.

Both "direct" and "indirect" bankruptcies are available to debtors. A "direct" bankruptcy refers to the debtor's or creditor's immediate request for a declaration of bankruptcy. "Indirect" bankruptcy means a liquidation proceeding declared only after a failed attempt to reorganize following the adoption of a reorganization plan.

Reorganization proceedings (concurso preventivo)

The Argentine Bankruptcy Act (Law 24.522, or the "ABA") provides procedural guidelines for composition proceedings that permit an insolvent debtor under court protection and supervision to craft restructure and repayment agreements with creditors. To initiate the proceeding, an individual or company must file information with the court demonstrating its inability to pay debts as they come due.

The intervening court decides whether to open a composition proceeding. In the petition, the debtor must identify the commercial cause for his/its insolvency and the factual situation demonstrating the payment default (*cesación de pagos*). Additionally, the debtor should present a detailed description of its assets, credits and debts, the last three balance sheets, and a list of existing credits, creditors, and commercial books. Shareholders must ratify the composition proceeding request within 30 days of the presentation.

Opening a composition proceeding places a debtor under the supervision of a trustee (Síndico). The debtor remains in control of the business, subject to restrictions imposed by law. For example, a debtor may not gratuitously assign or change its estate, nor may it encumber or sell it (*inhibición general de bienes*). The debtor, partners of limited liability partnerships and members of the Board of Directors of insolvent entities must inform the court before travelling abroad, and trips exceeding 40 days require court authorization. Lastly, commercial transactions related to registered assets, the transfer of going concerns, the issue of debentures and debt bonds, and the granting of mortgages or pledges also require court authorization.

Despite their restrictive character, composition proceedings are largely designed to benefit the debtor. Filing a composition proceeding stays accrued interest on unsecured claims as of the time of filing the petition with the court. Pursuant to a recent amendment, interest on labor credits is not stayed. In addition, the insolvent party may request that the court terminate or continue executory contracts. Where no notice of continuation is issued, parties operating under these contracts may terminate them. Reorganization proceedings also ensure the continuation of public services provided to the insolvent party as such services cannot be terminated based on debts existing prior to the commencement of said proceeding.

For the allowance of claims (*verificación de créditos*), all creditors must submit to the trustee proofs of claims stating their credits and preferences. The court will subsequently determine the admissibility of each claim. Within 10 days following the court's resolution, the debtor must submit to the trustee a proposal for classifying creditors. Factors influencing a creditor's classification include amount, securities and type of claim. The debtor must submit payment proposals to the creditors in each category for approval within a 90-day period from the date creditors were classified, known as "período de exclusividad".(*exclusivity period*) The court may extend this term for an additional 30 days. Court approval requires an absolute majority of creditors, representing at least 2/3 of the claims admitted in each class.

The Negotiable Obligations Act (Law 23.576), a body of statutes governing debt securities, requires unanimous approval to modify "essential" terms like maturity, principal or interest. Thus, the Negotiable Obligations Act protects bondholders from nonconsensual changes to essential terms. Reorganization arrangements, which allow for majority approval (a majority being all creditors representing at least 2/3 of unsecured claims), undermine this statutory guarantee. Both the ABA and the Negotiable Obligations Act are silent as to statutory conflict and both are federal laws of equal hierarchy. Nonetheless, the Argentine courts have determined that ABA provisions will prevail over those of the Negotiable Obligations Act.
Within three days of the filing of the acceptance, the court must rule that a reorganization arrangement exists.

Section 50 of the ABA permits creditors to challenge reorganization arrangements. Typical creditor challenges include a lack of requisite majority, fraudulent increase of debtor's liabilities or lack of class representation. A challenging creditor must file the challenge within five days of notice of the existence of a composition arrangement. If the court accepts the challenge, it will notify the debtor and trustee, each of whom must respond within five days of notice. The court may reject the challenge and confirm the composition arrangement, or it may accept it and declare bankruptcy.

Judicial confirmation of the reorganization arrangement notwithstanding, a party may still bring a nullity action based on fraud. The action must be filed within six months of the confirmation of the agreement.

Out of Court Restructuring (Acuerdo Preventivo Extrajudicial)

Sections 69 to 76 of the ABA offer parties a means to restructure without judicial involvement. These sections, amended in May 2002, allow a debtor to agree with the majority of its creditors on a "prepackaged" out-of-court reorganization plan (*acuerdo preventivo extrajudicial*, or "APE") which, upon judicial confirmation, becomes binding on creditors. Despite their appeal to debtors, as well as major creditors looking to efficiently restructure without a bankruptcy proceeding, APEs leave bondholders in a much more tenuous position.

APEs are structured by private agreement to rehabilitate the debtor without the need for an insolvency proceeding. Preventive in nature, the plan is wholly determined by the parties, subject to certain legal limitations. APEs are presented in two phases, one out-of-court and one in court consistent with explicitly outlined procedures. Additionally, the content of the agreement may be specific to each creditor class.

APEs are negotiated between the debtor and its unsecured creditors, subject to judicial endorsement. Once endorsed, the APE is enforceable against all unsecured creditors, including those refusing to be party to the agreement.

Creditors acknowledged by the debtor and those summarily evidencing the debtor's failure to include them in the statement that the debtor must file are entitled to challenge an APE within 10 days following the last of notice—through the official gazette—of the announcement that the APE was filed for confirmation. A debtor's challenge at this time may only be made on the basis of omission or overstatement of the assets or liabilities or the lack of requisite majority.

APEs differ from a judicially-supervised *concurso preventivo* because:
- APEs do not require as a condition *sine qua non* that the debtor is failing to pay debts as they become due (*cesación de pagos*). Instead, it allows the debtor to restructure debt at the beginning of financial difficulties, prior to reaching actual insolvency;
- the APE process is not entirely judicial, and is negotiated out of court;
- different covenants can be agreed to with different creditors;
- the debtor is not subject to limitations in the administration of his property;
- the debtor is not prevented from travelling abroad;
- interest on claims is not automatically stayed; and
- judicial authorization is not required to agree to all aspects of the agreement.

The APE is favorable to reorganization because it affords the parties more flexibility in resolving disputes. Likewise, it presents far less limitations to the debtor. However, it does present certain disadvantages as the debtor has a smaller negotiating voice when contrasted against its creditors. Furthermore, interest and tax obligations are not suspended as a result of the agreement.

"Cramdown" Procedure

Argentine insolvency law also provides a process (referred to by statute as "cramdown") by which dissenting creditors, a so-called "labor cooperative" (*cooperativa de trabajo*), a cooperative entity (even in the formation stage) constituted by workers of the insolvent company, or other third parties may acquire control of a debtor that fails to obtain approval for a restructuring plan. If the required majority does not approve a reorganization proposal furnished by a debtor (in this case, a legal person), within 48 hours of termination of the exclusivity period, the respective judge shall, for five days, allow creditors and third parties to register with the intent to acquire the insolvent company. The judge must also determine the company's net worth, appoint an appraiser to value creditors' claims and order a hearing. In the case of a labor cooperative, their members' updated credits can be used to set off against the relevant acquisition price. If no parties register during the 5-day period, the company will be declared bankrupt.

Registered parties, as well as the debtor, must present a reorganization plan to creditors. The plan may or may not alter creditor classifications and its contents are not restricted. The reorganization must be approved by an absolute majority of creditors representing at least 2/3 of the claims allowed in each class.

The first registered party to obtain written acceptance and file it along with the reorganization plan to the respective court acquires the right to purchase the totality of the insolvent's shares. The respective party must deposit 25% of the offered value as a guarantee. The purchase price must be a value higher than that initially decided determined by the judge. If such value is negative, the acquiring party is under no obligation to pay for the shares. Within three days of the filing of the acceptance, the court must rule that a reorganization arrangement exists.

Regarding the challenge to the reorganization, the same principles apply as described for the *concurso preventivo* (reorganization). The judicial confirmation of the reorganization arrangement notwithstanding, a party may still bring a nullity action based on fraud. The action must be filed within six months of the confirmation of the agreement.

Bankruptcy

Debtors must be insolvent before bankruptcy becomes a viable option for a company in financial distress. A bankruptcy proceeding is available after the failure of a reorganization proceeding or if a debtor voluntarily seeks bankruptcy, or upon request of at least one creditor. The request by the creditor requires evidence that the debtor failed to pay debts as they matured. The debtor has five days to challenge the creditor's petition.

Declaring bankruptcy immediately imposes obligations and restrictions on the debtor, its representatives and its administrators, including:
- the obligation to cooperate with the court judge and the receiver to identify assets and claims;
- the prohibition of travelling abroad without prior authorization by the court;
- the transfer, sale or other disposition of any right to corporate assets existing at the time of the declaration of bankruptcy;
- the administration by the receiver of the debtor's assets and the receiver's participation in their disposal in the manner prescribed by law; and
- the loss of the right to use divested assets to cancel adverse claims or judgments.

Within 24 hours of the bankruptcy declaration, notice of the case must be published in the Official Gazette and in a local newspaper for five days. This notice and publication is required in each jurisdiction in which the insolvent maintains a business presence, in addition to the place where the responsible partners live. A debtor who satisfies section 5 of the ABA may, within 10 days of the last publication, convert the liquidation proceeding into a reorganization proceeding.

Ascertaining the date of insolvency is critical in a bankruptcy proceeding. Depending on the date of insolvency, the bankruptcy court may grant a retroactive reach-back period (*período de sospecha*) not exceeding two years prior to the declaration of bankruptcy or the filing of a reorganization plan. The resolution establishing the date of insolvency may be appealed by intervening parties or by the debtor.

In bankruptcy, creditors may only enforce rights in divested assets in the manner prescribed in the ABA. All creditors must file proofs of claims, requesting their judicial approval (*verificación de créditos*) of respective credits and preferences. Creditors who have issued non-monetary loans contracted in foreign currency or whose monetary value is tied to other assets, must convert the value of such loans into legal Argentine currency (Argentine pesos) in the event of bankruptcy. The creditor may opt to value the loans at the date of declaration of bankruptcy or, if earlier, at the date of maturity of the obligation.

Some creditors may enjoy a preference with respect to the distribution of the debtor's assets (priority creditors). One special case refers to specific assets over which the creditor holds a

preferential right. These preferences include (1) construction, improvement and maintenance expenses of assets possessed by the debtor, over those assets, (2) salaries and other remuneration due for workers' compensation, seniority, termination and lack of prior notice, over merchandise, raw materials and machinery of the debtor's premises, (3) specific taxes and duties; and (4) mortgages and other security interests. A general preference typically refers to a class of claims (e.g., wages, social security and taxes) payable first out of the debtor's estate.
In most cases, the majority of creditors have no preferential status, either by lien or priority (general creditors)

Labor cooperatives can request the continuation of a company's operations.

Regardless of a labor cooperative request, within 20 calendar days of accepting the charge, the receiver must inform the court of the practicability of maintaining the company as an on-going concern. The receiver's report must specifically consider a labor cooperative request, and include:
- the possibility of continuing operations without incurring new liabilities;
- the benefit creditors and third parties of maintaining the company;
- a carefully supported plan of development and resources;
- current agreements that must be maintained;
- the reorganization and modifications necessary to make the development of the company economically feasible;
- the collaborators needed to supervise the development; and
- a detail of the manner in which pre-existing debt will be serviced.

In the event that the bankrupt business is continued by a labor cooperative, they shall receive governmental technical support. In this case, foreclosure of assets is conditioned upon: i) the credit being due and unpaid, and ii) the existence of a final judicial acknowledgment of the credit. Even if these conditions are met, the bankruptcy court can still stay foreclosures for up to two years, at the labor cooperative's request.

The receiver also possesses the right to liquidate the company. There are three methods of liquidation available to the receiver: (1) sell the entire company as an on-going concern, (2) sell company assets in bulk; or (3) sell company assets gradually.

Proceeds from these sales will be applied to administrative costs, with any surplus being distributed to creditors, according to their preferences.

Pursuant to a recent amendment, labor cooperatives can acquire the assets of the bankrupt company. They are thus entitled to compensate their credits against the relevant price.