FINANCING COMPANY GROUP RESTRUCTURINGS

Edited by

Gregor Baer
Karen O'Flynn

OXFORD
UNIVERSITY PRESS

OXFORD
UNIVERSITY PRESS

Great Clarendon Street, Oxford, OX2 6DP,
United Kingdom

Oxford University Press is a department of the University of Oxford.
It furthers the University's objective of excellence in research, scholarship,
and education by publishing worldwide. Oxford is a registered trade mark of
Oxford University Press in the UK and in certain other countries

First Edition published in 2015

Impression: 1

Published in the United States of America by Oxford University Press
198 Madison Avenue, New York, NY 10016, United States of America

British Library Cataloguing in Publication Data
Data available

Library of Congress Control Number: 2015942290

ISBN 978–0–19–873846–6

Printed and bound by
CPI Group (UK) Ltd, Croydon, CR0 4YY

1

ARGENTINA

*Tomás M Araya**

A. Introduction: Argentine bankruptcy law overview

Argentine Bankruptcy Law ('Bankruptcy Law') distinguishes three types of proceedings governing insolvency of debtors: out-of-court reorganization proceedings (known as '*acuerdo preventivo extrajudicial*' or 'APE'), reorganization proceedings (known as '*concurso preventivo*'), and bankruptcy liquidation proceedings (known as '*quiebra*'). **1.01**

Once a reorganization proceeding is opened by the court, a trustee or receiver ('*síndico*') is appointed to control and supervise the debtor's existing management—in **1.02**

* The author would like to express his gratitude to M & M Bomchil associate Pedro de Elizalde for his valuable help in reviewing the cases mentioned in this chapter. The material contained herein is intended as a general guide only and is not intended to be a memorandum of law study, nor to provide legal advice, and should not be treated as a substitute for legal advice concerning particular situations. Legal advice should always be sought before taking any action based on the information provided. The publishers, editors, and author bear no responsibility for any errors or omissions contained therein.

the case of a corporate debtor, its board—which continues running the business during the proceeding.

1.03 In the out-of-court reorganization proceeding ('APE'), no receiver is appointed and the debtor seeks out of court to obtain required consents to its restructuring plan and then file for judicial approval of the plan.[1]

1.04 On the other hand, under a bankruptcy liquidation proceeding, a court appointed receiver replaces the debtor's management (or its board, when dealing with a corporate debtor) and assumes management of the business with the primary goal of liquidating the debtor's assets and distributing the proceeds among the admitted claims, in accordance to the priority rules set forth by the Bankruptcy Law.

1.05 As a requisite to any bankruptcy proceeding, a debtor must prove that (i) it is an 'eligible debtor'[2] under the Bankruptcy Law, and that (ii) it is in cessation of payments, which is understood as a permanent status affecting the debtor's ability to regularly meet the obligations when they become due. Although lack of payment of an obligation does not necessarily imply that the debtor has reached a cessation of payments status, non-fulfillment of a payment obligation is normally used as evidence of the debtor's cessation of payments by creditors seeking the opening of the debtor's bankruptcy liquidation proceeding. The debtor's own statement of being in a cessation of payment status at the filing of a bankruptcy liquidation or a bankruptcy reorganization proceeding is normally accepted by the courts as sufficient evidence of such status.

1.06 Further, the law authorizes a group of companies which are part of a permanent economic group ('*conjunto económico*') to jointly file a bankruptcy reorganization petition. Each group entity will be subject to its own individual reorganization proceeding, although the proceedings will be related as the court will appoint only one receiver for all proceedings. The petition must include all group entities and the debtor must state that the cessation of payment of at least one of the group entities (which is a requisite for the joint group entities filing) may affect the other members.[3]

1.07 Debtors normally try to avoid a bankruptcy filing when facing financial distress. As their first option they usually try to obtain a voluntary postponement with their

[1] Notwithstanding that the out-of-court agreements had been incorporated into the bankruptcy law in 1983, the APE achieved wide use after 2002, when the Bankruptcy Law was amended by the passing of Law No 25,589, which provides that a judicially approved APE plan would bind dissenting creditors.

[2] Under Argentine Bankruptcy Law, the following individuals or entities are considered as 'eligible debtors': (i) individuals; (ii) private legal entities; (iii) legal entities that are partially owned by the national, provincial or municipal Argentine State; (iv) a deceased estate (as long as it continues to be independent from the estate of its successor); and (v) debtors domiciled abroad with respect to the assets located in Argentina.

[3] Please see Section 1.7 for further information on group filings.

creditors and if the needs of financing operations cannot be covered by external means as bank loans, they may evaluate the sale of certain assets, to obtain liquidity. This type of sale may raise concerns if the company is finally unable to overcome financial distress and it is forced to file for bankruptcy.

B. Financing a group restructuring before insolvency proceedings

Bank financing to a group of companies in financial distress is not common in Argentina. Traditionally, the typical sources of finance for distressed companies have been insiders (ie current shareholders or a group member), existing creditors, and in some specific and sensitive cases, the government. This type of financing may raise certain issues on a subsequent bankruptcy proceeding which are addressed herein below, after a brief overview of the bank regulations regarding loans to financially distressed companies. **1.08**

1.1. Bank regulations

Loans to financially distressed companies are normally not attractive to banks, as the applicable regulations issued by the Argentine Central Bank ('BCRA') tend to discourage this type of financing. Further, collection costs in case of default are also relevant and dis-incentivize financings to companies which are unable to show a favorable cash flow. **1.09**

According to the BCRA regulations,[4] the capacity of a bank to make loans is limited by its own net worth adjusted by certain BCRA rules and known as 'eligible regulatory capital' ('*responsabilidad patrimonial computable*' or 'RPC') as well as the borrower's eligible regulatory capital or RPC. Initially, the amount of financing that can be provided to a company cannot exceed the borrower's eligible regulatory capital. However, additional assistance up to three times the borrower's eligible regulatory capital is allowed, if this amount doesn't exceed 2.5 per cent of the eligible regulatory capital of the bank. **1.10**

BCRA regulations require that only 'normal situation' loans (which are loans with virtually no risk of default) are allowed to be taken into account without deducting any 'loan loss provision' when calculating each bank's eligible regulatory capital. **1.11**

A loan loss provision is a reserve for defaulted loans. Banks anticipate that not all loans granted will perform as expected, and therefore set aside a fraction of each loan to cover this loss, mandating that the full amount of the loan will not be included when estimating its eligible regulatory capital. The amount set aside will **1.12**

[4] BCRA Communication 'A' 3002, as amended.

depend on the risk of repayment of each loan. For instance, according to BCRA rules,[5] a loan with low risk of default will have to provision between 3 and 5 per cent, while a loan with medium risk of default will have to provision between 12 and 25 per cent. In both cases, the provisioned amount will not be counted as an asset when estimating the bank's eligible regulatory capital.

1.13 Consequently, banks have an incentive to provide financing only to well-off companies. These types of loans are subject to the lowest provision rates and thereby improve the banks' eligible regulatory capital, to a certain extent, increasing their capacity to provide additional funding.

1.14 Furthermore, BCRA regulations mandate that these restrictions be applied to each individual company looking for financing, not on the group as a whole. Conversely, other restrictions (notably, those referred to risk concentration)[6] are applied on a group basis, not on an entity basis. This further decreases the possibility that companies which are members of a distressed economic group will obtain bank financing.

1.15 In effect, for credit limit purposes, groups or 'related entities' in the private non-financial sector are considered as a single client. The definition of 'related company' is specifically set out in the Central Bank regulations and is based on control of the companies' affairs, which is determined by stock ownership, number of board members shared by the companies, and actual or potential participation on the governing bodies. Specifically, the Central Bank regulations provide that one company has control over another if the former directly or indirectly: (i) owns or controls 25 per cent of more of the votes in the company; (ii) owns or controls 50 per cent or more of the votes at the shareholders' meetings at which directors are appointed; or (iii) notwithstanding the number of votes, it has control over third companies which in turn may influence the company's decisions.[7]

1.2. Insiders' financing contributions

1.16 When a single company or a group of companies face financial difficulties, sources of financing are normally limited to shareholders or existing creditors. Shareholders have an incentive to provide financing, directly or through affiliated companies, in order to keep the business alive and under their control in the hope of a prompt recovery.

1.17 The injection of new money may cause conflicts among shareholders when there are different views as to the strategy to be adopted by the company's management to overcome distress, as a shareholder who fails to contribute new funds

[5] BCRA Communication 'A' 2729, as amended.
[6] BCRA Communication 'A' 5472.
[7] Annex I of BCRA Communication 'A' 2140, as amended.

according to its *pro rata* participation will have its participation diluted. The amount of dilution will depend on whether the shareholders' meeting decides to issue the new shares at par value or with a specific premium, which is decided by comparing the company's net worth vis-à-vis its stock capital. The higher the amount of the premium, the less the dilution will be for the non-contributing shareholder.

1.18 While new shares may generally be issued with a premium when the company's net worth exceeds the company's stock capital,[8] there is scholarly debate as to whether the shareholders' meeting has discretion to fix the premium based on business justifications or if, on the contrary, the premium should reflect the exact difference between the company's net worth and the stock capital, divided by the number of outstanding shares.

1.19 Alternatively, controlling shareholders or third party affiliates may decide to grant an irrevocable equity contribution ('*aporte irrevocable de capital*'), which—if certain conditions are met—may be computed within the company's net worth and thereby improve its patrimonial situation.

1.20 The administrative agency in charge of the Public Registry of Commerce in the City of Buenos Aires (called *Inspección General de Justicia* or 'IGJ') mandates that, when documenting an irrevocable equity contribution, the contributing party must agree that its claim will be subordinated to all other unsecured existing claims if the company subsequently becomes insolvent.[9]

1.21 Regulations in effect in the City of Buenos Aires impose a 180 day-term[10] (counted as from the board's approval of the irrevocable equity contribution) for the company's shareholders' meeting to decide the capitalization of such contribution. If the shareholders' meeting fails to reach a decision on the capitalization of the irrevocable contribution within such term, then the amount of the contribution can no longer be computed within the company's net worth and must be registered as a liability and reimbursed to the third party contributor.

1.22 If the company is unable to overcome its financial distress and needs to file for bankruptcy, the insiders' claim arising from the non-capitalized irrevocable equity contributions must be admitted as subordinated claims in the company's insolvency proceeding, as per the consensual subordination clause required by the IGJ's above referred regulations.

[8] Although s 202 of the Commercial Companies Law states that the shareholders meeting *may* decide to issue the new shares with premium, the courts have concluded that such right turns into an obligation when the company's net worth exceeds the corporate stock capital ('*capital social*'). See, generally, '*Lurie c. Ponieman S.A.*', Commercial Court of Appeal, Courtroom B, 19 May 1997 (<www.societario>, reference nr 7578) (modifying the criteria adopted in '*Augur S.A. c. Sumampa S.A.*', Commercial Court of Appeal, Courtroom C, 28 December 1984 (LL 1985-E, 12).

[9] Article 96, V, 1 h) of reg 7/05 issued by the *Inspeccion General de Justicia* on 23 August 2005.

[10] Regulation 7/05 issued by the *Inspeccion General de Justicia* on 23 August 2005, art 96, IV, 1 a).

1.23 Finally, loans are the third alternative for insider financing. The recovery risk of such loans will be entirely borne by the lender, without imposing an obligation on the non-contributing shareholders to inject new funds on the company.

1.24 Upon a subsequent bankruptcy proceeding, there is a risk that the court might decide to subordinate claims arising from loans granted by majority shareholders on the argument that the company was undercapitalized when the funds were provided by the shareholder or by an affiliate.

1.25 While the 'subordination of insider loans' doctrine has not been generally adopted by the courts so far, the National Commercial Court of Appeals recently affirmed a decision subordinating an insider loan granted during financial distress prior to a bankruptcy filing.[11] In this case, the court decided that a loan advanced by a shareholder when the company was insolvent cannot be treated as an ordinary claim, as this would imply a transfer of the owner's commercial risk to third parties.

1.26 *Diaz Quirini* was the first case in which a shareholder loan granted during the company's cessation of payment status was subordinated in an insolvency proceeding, causing in effect the re-categorization of the loan as equity. It is yet to be seen, however, if this doctrine will evolve as an *objective* doctrine requiring subordination of all types of insider financing granted within a certain period of time prior to insolvency or if, on the contrary, subordination will be limited to financing by certain types of insiders (for example, majority shareholders) made on different terms and conditions than would have applied in a non-related third party transaction (a *subjective* approach).[12] In any case, this matter is relevant to any kind of insider financing provided to a group of companies in financial distress and should be carefully analyzed prior to entering into this type of transactions.

1.3. Third parties' financing contributions

1.27 The second alternative for companies in financial distress is third party financing, normally by existing creditors or, in some specific cases, the government.

1.28 In the first case, an existing creditor (normally a bank) decides to grant new money and normally demands adequate assurance of repayment, which may be in the form of a security interest on the debtor's assets or on a third party guarantor's assets.

---

[11] '*Diaz y Quirini SA s/concurso preventivo s/incidente de revisión promovido por Quirini Augusto*', National Commercial Court of Appeals, Courtroom C, 31 May 2012. <www.laleyonline.com.ar> AR/JUR/29199/2012.

[12] A 2005 proposed amendment to the Commercial Companies Law adopted the objective approach, mandating that any claim owned by a shareholder holding at least 10% of the debtor's capital stock and votes will be subordinated to other claims upon a subsequent bankruptcy proceeding of the debtor (see 2005 Bill to amend the Commercial Companies Law N° 19,550 drafted by Professors Jaime L Anaya, Salvador D Bergel and Raúl A Etcheverry).

When a financially distressed company grants a security interest on its own assets, lenders should be aware of the risk that the collateral might be subject to an avoidance action if the company ends up in a bankruptcy liquidation proceeding.[13] In addition, in cases where an affiliate grants a guarantee as additional security, lenders should also be aware that if the guarantor ends up in bankruptcy, creditors may object the enforcement of the guarantee arguing that it was a gratuitous act, granted for the benefit of a third party. These concerns are addressed below. **1.29**

Finally, in recent years there have been some cases involving large companies in financial distress that have managed to obtain government financial aid, provided they commit to keep their workforce without implementing layoffs. Financial aid has come either as loans from government-owned banks or as subsidies to be specifically allocated for the payment of salaries. **1.30**

1.4. Role of guarantees in group financing

Guarantees play an important role in financing a financially distressed group of companies. Affiliated companies may serve as full guarantors or may agree to grant a security interest (ie pledge or mortgage) on their own assets to guarantee performance of the company's debtor obligation. **1.31**

Should the affiliated company end up in a bankruptcy proceeding, creditors may object to enforcement of the guarantee provided by the affiliate, arguing that it was not granted for the affiliate's own benefit and was therefore '*notoriously strange* to the company's corporate purpose', thereby violating s 58 of Commercial Companies Law N° 19,550.[14] **1.32**

When analyzing enforceability of guarantees granted by affiliated companies in a subsequent insolvency proceeding, certain courts have adopted an 'entity' approach, sustaining enforceability of guarantees provided (a) the act of granting guarantees is included within the company's corporate purpose, and (b) if the guarantor has received compensation for granting the guarantee.[15] For instance, the Commercial Court of Appeals has ruled that a guarantee granted by a company in favor of a third party is invalid if it provides no benefit to the guarantor, as a company's actions must be limited to the purpose of seeking profits.[16] Likewise, some courts have ruled that even in cases where the act of granting guarantees in **1.33**

[13] See Section 1.5 'Avoidance actions'.

[14] Section 58 of the Commercial Companies Law sets forth that the company's legal representative binds the company for any act which is not 'notoriously strange' to the company's corporate purpose.

[15] '*Sabavisa S.A. s. concurso preventivo s. inc. de revisión por Citibank N.A.'*, National Commercial Court of Appeals, Courtroom D, 3 June 2009 (<www.societario.com>; reference nr 16126).

[16] '*Canteras Cerro Negro s/incidente de revisión en autos: "El Abuelo s/Quiebra*"'; CCiv y Com Mar del Plata, Courtroom I, 16 February 2006 (<www.societario.com>; reference nr 14102).

favor of third parties is expressly mentioned in the company's bylaws, enforceability nonetheless requires that the guarantee directly benefitted the guarantor.[17]

1.34 Other courts have been more flexible and accepted the possibility that a guarantee provided to an affiliate may be considered beneficial to the guarantor when the funds have been used, at least partially, for the benefit of the group. In this regard, the National Commercial Court of Appeals has recently held, in obiter dictum, that an indirect benefit or compensation by virtue of belonging to the same economic group could make the guarantee enforceable.[18]

1.35 Scholars' views on this subject have been far from unanimous. While some reject the possibility of an indirect benefit being sufficient to make such a guarantee effective in a subsequent bankruptcy proceeding of the guarantor, other authors have argued that while some form of compensation to the guarantor is required, it need not necessarily be an immediate financial benefit. In this sense, it has been argued that the 'compensation' requirement could be deemed satisfied if the guarantor receives some type of 'organizational advantages' by way of its being part of a group as a whole.[19]

1.36 In any case, creditors should be aware that they may face difficulties when enforcing guarantees granted by a third party which winds up in bankruptcy if there is no clear evidence of the benefit received by the guarantor when providing the guarantee. Specifically, up-stream guarantees will be closely scrutinized upon a guarantor's bankruptcy proceeding and if the creditor is unable to show that the guarantor has received an actual benefit from the underlying act which was guaranteed, then the guarantee might not be enforceable in the guarantor's bankruptcy proceeding.

1.5. Avoidance actions (claw-back actions)

1.37 The Bankruptcy Law states that, while in a bankruptcy liquidation proceeding, the receiver (or any admitted creditor, upon failure to act by the receiver) may demand the avoidance of any act performed by the debtor during the 'suspicious period'.

---

[17] '*Policronio S.A. s/conc. orev s. inc. De revisión por la concursada al crédito Revello Jorge*' National Commercial Court of Appeals, Courtroom C, 11 August 2006 (ED 220–463).

[18] '*Szwarcberg Hermanos S.A. s/conc. prev. s/inc. de rev. prom. por Soto, Claudia Noemí*', National Commercial Court of Appeals, Courtroom E, 3 September 2009 (<www.laleyonline.com.ar>AR/JUR/45064/2009). In this case, the court decided that the guarantee was unenforceable in bankruptcy because the benefit (for the guarantor) had not been demonstrated. See also: *'Cía Frigocen s. conc. prev. s. inc. rev. por Banco Patagonia'*, National Commercial Court of Appeals, Courtroom A, 9 May 1991. ED 147, 339.

[19] OTAEGUI, Julio C, 'Actos notoriamente extraños al objeto social. La fianza y la falencia'; ED 187-29. See also TÉVEZ, Alejandra, 'Hipoteca a un tercero como acto notoriamente extraño al objeto social. Implicancias de la verificación del crédito en el proceso concursal del hipotecante'; La Ley 2007-D, 889.

The 'suspicious period' runs from the date when the debtor's cessation of payment starts until the bankruptcy liquidation is declared, but cannot reach back beyond two (2) years before the bankruptcy liquidation ('*quiebra*') order. The term is unique and applies to all parties, without distinction, between insiders and non-affiliated third parties. The statute of limitation for the filing of these actions is two (2) years from the date of the bankruptcy liquidation order ('quiebra'). **1.38**

According to the Bankruptcy Law, certain acts performed by the debtor during the suspicious period may be deemed avoided either because they are avoidable 'as a matter of law' (s 118 of the Bankruptcy Law) or because they may be avoided 'due to the knowledge of the cessation of payment status' (s 119 of the Bankruptcy Law). **1.39**

The acts avoided 'as a matter of law' are (i) any gratuitous act performed by the debtor; (ii) advance payments of debts scheduled to mature on the date of the bankruptcy liquidation order or thereafter; and (iii) the granting of mortgages, pledges, or any other kind of priority right as security for non-due obligations which originally were not entitled to such priority right. **1.40**

Additionally, the Bankruptcy Law provides that any other transaction executed by the debtor within the 'suspicious period' may be subject to avoidance by the court if (i) at the time the act was executed, the third party was aware of the cessation of payment status of the debtor; and (ii) the act is detrimental to the debtor's creditors (s 119 of the Bankruptcy Law). **1.41**

The burden of proving the lack of prejudice to the debtor's creditors lies on the third party defendant. This defence is generally not accepted when registered assets are transferred by the debtor and management allocated funds received to extra-corporate purposes. **1.42**

The avoidance power rules have been criticized on grounds that the long reach-back period (two years) creates significant uncertainty to third parties dealing with companies that afterwards become insolvent. Likewise, the fact that the initial date of cessation of payment needs to be determined by the court before reaching a decision, normally provides an incentive to the debtor, and any prospective defendant, to challenge the date of cessation of payment procedure. The result is to extend the duration of legal proceedings involving avoidance actions, which ends up increasing litigation costs and reducing funds available for distribution to creditors. **1.43**

Prepetition financing secured by collateral granted by the debtor during the suspicious period may be subject to a claw-back action seeking to declare the collateral without effect vis-à-vis the debtor as a matter of law if the mortgage, pledge or any other preference was granted to secure a non-due obligation which originally was not entitled to such priority. **1.44**

In this regard, the National Commercial Court of Appeals has declared without effect vis-à-vis the debtor certain guarantees granted to a creditor within the **1.45**

two-year period before the initial date of cessation of payments, stating that the new financing provided was closely connected to already existent debt and therefore could not validly include new guarantees.[20] The fact that the financing was actually intended to guarantee previously unsecured claims determined the outcome of the case, as the court noted that the purpose of the claw-back action was to preserve the *par conditio creditorium*, preventing debtors favoring unjustly certain creditors to the detriment of other unsecured creditors.

1.46 While the avoidance actions as a 'matter of law' ('Section 118' actions) have a rather limited scope (as they exclusively cover gratuitous acts or advance payments or guarantees granted in favor of non-matured unsecured claims), the avoidance actions due to the knowledge of the debtor's cessation of payment ('Section 119' actions) may reach *any* type of acts that occurred during the debtor's 'suspicious period', which as mentioned, may reach up to two years before the bankruptcy liquidation order.

1.47 In this sense, lenders should be aware that a security interest granted in a loan restructuring may end up being challenged by an avoidance action if the debtor files for bankruptcy within the following two years, and the proceeding ultimately results in a bankruptcy liquidation (*'quiebra'*) proceeding. Courts have generally been quite rigorous in assessing the required knowledge of the creditor's cessation of payments when the creditor is a bank, stressing that these entities normally are aware (or should be aware) of the debtor's financial information as a result of their relationship with the debtor.[21] Courts have generally granted relief in this type of avoidance action when there is evidence proving that when the security interest was granted in respect of a previously unsecured claim, the lender was indeed aware of the company's cessation of payment status.[22]

1.48 Likewise, intercompany loans guaranteed by collateral granted during the debtor's 'suspicious period' may also be subject to avoidance actions if the debtor later on ends in bankruptcy liquidation and it is proved that the creditor was aware of the debtor's cessation of payment at the time the collateral was granted. Intercompany transactions are likely to be scrutinized in a bankruptcy and may be subject to claw-back actions, particularly when they are not executed at arm's length and the ultimate result of the transaction is to reduce the collection rate of unsecured creditors by reducing the debtor's assets.

[20] '*Frigorífico Gral. Rodríguez S. A. c. Banco de la Ciudad de Buenos Aires y otro*' National Commercial Court of Appeals, courtroom B, 31 July 2000 (LA LEY 2001-A, 126).

[21] *'Asociación Mutual de las Fuerzas de Seguridad s/quiebra c. Banco del Sol S.A'.* National Commercial Court of Appeals, Courtroom C. 17 December 2013. ABELEDO PERROT Nº: AR/JUR/96282/2013*; 'Desaci Diesel Electromecánica S.A. s/quiebra c. Banco Sudameris S.A'.* National Commercial Court of Appeals, Courtroom E, 13 March 2008 (ED 229-152).

[22] *'Desaci Diesel Electromecánica S.A. s/quiebra c. Banco Sudameris S.A'.* National Commercial Court of Appeals, Courtroom E, 13 March 2008 (ED 229-152).

1.6. Liability of directors of companies in the 'Zone of Insolvency'

1.49 The Bankruptcy Law does not contain a provision mandating that the debtor file for bankruptcy within a certain time after initiation of its cessation of payment status.

1.50 Nonetheless, courts have found those in charge of the debtor's management liable to creditors as a result of having unnecessarily delayed the filing, if it was clear that the company was indeed in a cessation of payments status and no alternative means to recover from such status were expected.[23]

1.51 Directors may be subject to liability under the Commercial Companies Law for a breach of their duties to act with loyalty and with the 'diligence of a good businessman'. Further, if a bankruptcy proceeding is opened, directors may also be found liable under the liabilities actions set forth in the Bankruptcy Law.

1.52 Under those Bankruptcy Law provisions, director liability will be imposed where directors' actions or omissions were performed with willful misconduct and have produced, facilitated, allowed, or aggravated the company's financial distress or its insolvency. The Bankruptcy Law requires that a majority of unsecured creditors consent prior to the filing of a bankruptcy liability action.

1.53 Under the Commercial Companies Law, directors may be held liable if they breach their duties to act with the diligence of a 'good businessman' or with loyalty, either with negligence or willful misconduct. Further, s 274 of the Commercial Companies Law provides that directors are jointly and severally liable to the company, the shareholders and third parties for wrongful behavior in fulfilling their duties (in accordance with the standard set forth by s 59) or infringing the law, the articles of incorporation, and by-laws, and for any other damage caused by directors' malice, abuse of authority, or gross negligence.

1.54 By contrast, the Commercial Companies Law's liability standard does not require proof of the director's willful misconduct and is thus less rigorous than that of the Bankruptcy Law. Commercial Companies Law liability actions may be brought against directors even if the company is in a bankruptcy proceeding, although courts have concluded that such actions are not subject to unsecured creditors' prior approval. These actions may be initiated by the receiver or by any other creditor if the receiver fails to act.

1.55 In practice and notwithstanding the liabilities risks, management may resort to other means of restructuring (as sale of certain assets and voluntary exchange offers

[23] *In re 'Transportes Perpen S.A s/quiebra'*, National Commercial Court of Appeals, courtroom C, decided on 20 December 2006. <www.societario.com> reference nr 16363. In this case, the National Commercial Court of Appeals held directors liable for a debtor company's unpaid liabilities upon finding that the directors did not timely resort to a bankruptcy procedure, in a case involving failures of adequate accounting and filing of documents with willful misconduct.

to extend the payment terms of listed debt securities) prior to proceeding with a bankruptcy filing, due to—among other reasons—the lack of post-commencement financing.

1.56 Large companies which had to restructure their financial obligations after the 2002 financial crisis chose the workout reorganization proceeding ('APE'), which allowed them to negotiate with lenders and bondholders out of court, while retaining management of the company during the process. As mentioned, the APE proceeding is more attractive and cost-efficient in comparison to traditional reorganization proceedings, as it allows the restructuring agreement to be imposed on non-consenting creditors (provided a certain majority of creditors consent)[24] and allows the debtor more flexibility in negotiating with creditors (as no receiver is appointed by the court).

C. Post-commencement financing

1.7. General overview of group filings

1.57 The Bankruptcy Law authorizes a group of companies which are part of a permanent economic group ('*conjunto económico*') to file a joint reorganization petition.

1.58 Each group entity will be subject to its own individual reorganization proceeding, although the court will appoint only one receiver for all related proceedings. The petition must include all group entities and the cessation of payment of at least one of the group entities (which is a requisite for the group filing) may affect the other members.

1.59 Once their reorganization proceedings are opened, group companies may choose to file either individual or unified plans during the term that the law authorizes the filing of proposals to the creditors, called the 'exclusivity period'.

1.60 If the group companies decide to file a unified plan, the required majorities (an absolute majority of the unsecured creditors, and two-thirds of the total outstanding amount of the unsecured claims) must be computed on a consolidated basis. Failure to obtain the majorities on such basis will result in the bankruptcy liquidation of all the group companies.

1.61 Conversely, if the debtors choose to file individual plans, then the majorities must be computed and obtained on an individual basis (ie, without consolidating the unsecured liabilities of each proceeding). Normally, group companies file unified plans and therefore the majorities are calculated on a consolidated basis.

[24] An absolute majority of the unsecured creditors representing at least two thirds of the outstanding amount of the unsecured claims must consent.

Whether plans are filed on an individual or on a consolidated basis, intra-group claims arising within a two-year period before the filing are not taken into account when estimating the aggregate unsecured claims upon which the required majorities must be obtained for a plan to be approved. This prevents the debtor's affiliates and the parent entity from exerting influence on the plan's approval. **1.62**

After obtaining the necessary consents, the companies seek court approval, which makes the reorganization plan applicable to all creditors. The judge must analyze whether the formal requirements are met and ensure that the plan does not constitute an abuse of creditor's rights or fraud to the applicable law. **1.63**

When considering a unified plan, courts are especially cautious, as the complexity of the proposed plan may conceal a violation of the rights of certain creditors. On this subject, the National Commercial Court of Appeals has denied judicial approval of a plan which proposed the merging of several affiliated entities into a new holding company and the capitalization of the admitted claims. The court concluded that the guarantees originally granted to certain secured creditors (which consisted of a pledge of the shares of one of the affiliated companies in bankruptcy) would be violated by the proposed merger of such affiliate into a new holding company, as the plan had not foreseen that the shares of the new holding company would be pledged in favor of the prior existing creditors.[25] **1.64**

1.8. Post-commencement group financing concerns

Post-commencement financing is rarely seen in Argentina, at least as that concept is traditionally understood in the US and some other jurisdictions. **1.65**

This is largely because Bankruptcy Law does not grant or recognize a senior priority to private lenders who provide post-commencement financing. The only exception, permitted by s 53 of the Financial Entities Law, grants a super priority ranking to the Argentine Central Bank's advances to a financial institution in a distressed situation, which are payable prior to any other claim, with the only exception of claims holding a security interest (as pledges or mortgages) and certain unpaid labour claims. The Bankruptcy Law otherwise lacks rules recognizing a senior priority for new financing. **1.66**

In addition, debtors in financial distress normally tend to exhaust all other alternatives prior to a bankruptcy filing, either by selling assets or seeking financing from insiders, group members, or third parties at high interests rates. This often leaves the debtor in a fragile financial situation, with normally all (or most) of its assets already provided as collateral to secure prepetition claims prior to any filing, which in turn makes new financing from third parties practically impossible. **1.67**

[25] '*Supercanal Holding S.A. s/conc. prev*'. National Commercial Court of Appeals, Courtroom A, 30 October 2009 (LA LEY 2010-B, 366).

1.68 Financing therefore normally comes from a parent company, an existing shareholder, or an affiliate with a positive cash flow position, at the request of a parent company. In addition, it is not uncommon for a parent company (or an affiliate) to directly assume or purchase claims against a bankrupt affiliate for satisfaction at a discount.

1.69 Insiders' voting rights are limited by the Bankruptcy Law. Section 45 of the Bankruptcy Law restricts as a matter of law the parent company's voting rights when they are also creditors, and does not compute their claims as part of the debtor's unsecured claims for purposes of voting on plan approval.

1.70 While it has traditionally been understood that this exclusion should be applied restrictively and only to cases expressly contemplated within this rule, courts have often extended the prohibition to other situations. For instance, the National Commercial Court of Appeals recently applied this restriction in cases where an affiliate provided financing to its parent company which later became insolvent.[26] The same court did not count the vote cast by a company that was under indirect control of the debtor, on the grounds that conflicting interests resulting from its status as both a creditor and an affiliate fall within the *ratio legis* of s 45 and mandate restriction of the company's voting rights as a creditor on plan approval.[27]

1.71 There is no precedent for conditioning post-commencement financing upon acknowledgment of the enforceability and validity of prepetition financing and security interests. It does not seem likely that such a practice would be allowed.

1.72 If a third party agrees to grant post-commencement financing to a group company member upon the granting of a security interest by a the debtor or a guarantee provided by an affiliate, it may be in lender's interest that the affiliate and the debtor (if either are in bankruptcy) seek court authorization before the funds are disbursed.

1.73 The court authorization should be sought under s 16 of the Bankruptcy Law, which requires court approval before a debtor enters into any act which is outside ('exceeds') the ordinary administration of the company's business ('[*actos*] *que excedan de la administración ordinaria de su giro commercial*'). Court authorization would protect financing provided during a bankruptcy reorganization proceeding against potential challenges in a subsequent bankruptcy liquidation proceeding, including claw-back actions.

1.74 The lender may request that the debtor obtain court approval of the debtor's (or its affiliate's) grant of a security interest in any of its assets in support of group

[26] *'Apartime S.A. s/conc. prev'*. National Commercial Court of Appeals, Courtroom B. 10 September 2007. <www.laleyonline.com.ar> AR/JUR/6023/2007.

[27] *'Inversora Eléctrica Buenos Aires S.A. s/conc. Prev'*. National Commercial Court of Appeals, Courtroom B. 13 July 2006. <www.laleyonline.com.ar> AR/JUR/4293/2006.

financing, arguing that the financing is beneficial to the debtor and the group of companies' debtors.

1.75 It is theoretically possible that a lender could lend new unsecured funds, not subject to a guarantee, to the debtor in bankruptcy reorganization without seeking court approval. These loans must be paid by the debtor when they become due, as they consist of post-petition obligations not subject to the automatic stay. However, in practice unsecured post-petition loans not guaranteed by third parties are rarely seen as the lender will be facing an enormous risk of default, without effective means of recovery.

1.76 Finally, though rarely seen, loans specifically designated for a particular purpose (as for instance the payment of salaries needed for the company to continue working) might be considered as 'administrative and court expenses' by the court, under the argument that these loans would benefit the debtor by allowing it to continue operating while in bankruptcy reorganization. 'Administrative and court expenses' enjoy top seniority on the priority of claims and must be paid as they become due.

1.9. Risk of 'excessive' affiliate financing in bankruptcy liquidation: extension of bankruptcy liquidation actions

1.77 When either pre- or post-commencement financing is granted to a company in distress through another affiliated group entity, and later on either party (lender or borrower) enters into bankruptcy liquidation proceedings, the lender's creditors may try to impose liability on the lender's directors arguing that the financing was 'excessive' and therefore not beneficial to the lender's own corporate purpose.

1.78 The general principle in Argentine law is that each company will be regarded as a different legal entity. Consequently, 'liability of a legal person cannot be extended to a different one, unless there is a legal cause that authorizes that extension'.[28]

1.79 There is no Argentine legal rule imposing per se liability on a controlling entity for the debts of its subsidiary, or automatically making the parent liable for its subsidiary's debts in bankruptcy.[29]

1.80 Nonetheless, the Bankruptcy Law provides for an 'extension of bankruptcy' action, applicable in bankruptcy liquidation proceedings only (that is not in bankruptcy reorganization proceedings), by which the bankruptcy liquidation is 'extended' from the debtor to a third party, causing the latter to also be declared bankrupt.

[28] '*Fortune María v. Soft Publicidad s. ordinario*', National Commercial Court of Appeal, Courtroom D, 3 November 1997 (ED 180-307).

[29] Section 172 of the Bankruptcy Law states that when two or more entities form an economic group, even when there is a controlling situation, the bankruptcy liquidation ('*quiebra*') of one of those entities shall not be extended to the others if the requisites stated in s 161 are not complied with.

1.81 Bankruptcy Law s 161 para 2 provides that when there has been an 'abuse of dominant position', the bankruptcy liquidation may be 'extended' to any controlling company that has unduly disposed of corporate assets of the debtor as if they were its own and imposed on the debtor a unified management for the benefit of the controlling entity or the economic group to which it belongs, in fraud of creditors. If the requisites set forth by the Bankruptcy Law are satisfied and relief under this section is granted the court will issue an order mandating the bankruptcy liquidation of the controlling entity. Taking into account the seriousness of this type of decision (which may involve an ongoing business with its own employees and creditors unrelated to the subsidiary, and have a direct impact on the parent entity creditors' rights), normally these actions take several years and the actual collection rate of creditors is uncertain.

1.82 For example, a court extended to a parent company the bankruptcy liquidation of its subsidiary when the parent company compelled an affiliate to provide, to the detriment of its own corporate interests, financing to a related entity, and this was a major cause of the affiliate's insolvency.[30]

1.83 While it is widely acknowledged that the 'extension of bankruptcy' actions in cases of abuse of dominant position should proceed only in situations of internal control of the debtor (ie, the control derived from owning a majority percentage of shares or participation rights), there have been isolated rulings where courts have extended the debtor's bankruptcy in situations where there has been external or economic control.[31]

1.84 Additionally, Bankruptcy Law s 161 para 3 establishes that when a commingling of assets and debts between the debtor and a third party entity impedes a clear delineation of assets and debts, extension of the debtor's bankruptcy liquidation to that third party may be requested. The Commercial Court of Appeals has considered that extension of bankruptcy in these cases must be applied restrictively, only when there is a commingling of both assets *and* debts and the existence of multiple companies affiliated to an economic group is a mere formality concealing a single economic entity.[32]

1.85 The third situation upon which a bankruptcy liquidation may be extended is the '*maître d'affaire*' extension, foreseen in s 161 para 1 of the Bankruptcy Law, which sets forth that bankruptcy liquidation may be extended to any persons who, under the appearance of the operation of the bankrupt entity, have executed acts in their

[30] '*Banco Medefin UNB S.A'* National Commercial Court of Appeals, Courtroom C, 30 June 2011 (ABELEDO PERROT Nº: 20110822).

[31] '*Tascar c. Nuevo Banco Santurce'*, National Commercial Court of Appeals, Courtroom C, 5 March 2004 (<www.laleyonline.com.ar> AR/JUR/711/2004).

[32] '*Calden S. A. en: Goñi Travella y Cía. S. R. L. s/quiebra'*. Civil and Commercial Court of Appeals of Rosario, Courtroom I, 16 June 2000 (<www.laleyonline.com.ar> AR/JUR/80/2000).

personal interest and disposed of the assets as if they were their property, in fraud of creditors.

If a court rules in favor of a creditor requesting the extension of the bankruptcy liquidation and there is a commingling of debts and assets situation, then one estate is formed including all assets and liabilities of both legal entities. Conversely, if the bankruptcy liquidation is extended due to an abuse of dominant position or on the '*maître d'affaire*' extension, two separate estates are maintained, keeping the division between the different creditors of each debtor, and the assets obtained from one estate shall be first used to pay the admitted claims of such estate and, if there is any surplus, then such surplus shall be transferred to the other estate to be allocated to the payment of this estate's admitted creditors. **1.86**

1.10. Priorities

In general, Bankruptcy Law recognizes three types of claims: unsecured (also called common), secured (which can be distinguished between general and special secured claims), and subordinated claims. In addition to these claims, administrative expenses, which are afforded priority treatment, normally play an important role in any bankruptcy proceeding. **1.87**

Unsecured claims, unlike secured claims, do not have a payment preference and can be satisfied from any assets of the debtor. In turn, secured claims may be distinguished between general secured claims—which hold a general privilege over all of the debtor's assets—and special secured claims—which are equivalent to security interest claims, holding a special preference over certain specific assets of the debtor. **1.88**

Finally, subordinated claims are those held by creditors who have agreed to postpone their collection rights until all other claims of the debtor have been paid (or whose claims have been specifically or individually subordinated to the same effect). **1.89**

The 'ranking' of priorities under Bankruptcy Law is as follows: **1.90**

(1) special secured claims or security interest claims ('*creditos con garantía real*'), which are satisfied by foreclosing the collateral;
(2) administrative expenses and fees;
(3) labour creditors holding a general secured claim;
(4) non-labour creditors holding a general secured claim;
(5) unsecured claims (which include labour unsecured claims); and
(6) consensual subordinated claims.

Secured claims may only affect 50 per cent of the proceeds obtained from the liquidation of the debtor's assets, after security interest claims, administrative, and court expenses claims ('Section 240' claims), and labour creditors holding a **1.91**

general secured claim are fully paid. If 50 per cent of the proceeds is not enough to pay the claims in full, then the unsatisfied amount of secured claims will be treated pro rata with all unsecured claims.

D. Financing multinational companies in insolvency

1.11. Cross-border insolvency matters under Bankruptcy Law

1.92 In Latin America, the 1997 UNCITRAL Model Law on Cross Border Insolvency has been adopted by Mexico (2000), Colombia (2006), and most recently, Chile (2014).

1.93 Argentina has not ratified the Model Law and therefore cross-border insolvency matters are still regulated by the Bankruptcy Law—which applies to cases not reached by the Montevideo Treaties—or by the rules contained in the Montevideo Treaties of 1889 or 1940, which applies among countries which are a party to such treaties.[33] Therefore, in cross-border insolvency cases which do not involve a country which is a party of the Montevideo Treaty, s 4 of the Bankruptcy Law shall apply.

1.94 The Bankruptcy Law does not contain rules of full recognition of foreign bankruptcy proceeding or rules of co-ordination of parallel bankruptcy proceedings. Neither are there rules requiring or recommending communication between local and foreign bankruptcy courts. The Bankruptcy Law deals only with some of the issues which can be encountered in cross-border insolvencies, applying mostly a 'territorial approach'.

1.95 Section 4 of the Bankruptcy Law permits the opening of a local bankruptcy proceeding at the request of either the debtor or a local creditor in case a foreign bankruptcy proceeding is opened, without the need of proving cessation of payment or the debtor's insolvency status. In this case, the local bankruptcy proceeding will be limited to the assets located in Argentina, which will be sold to pay the creditors' claims admitted in the local bankruptcy proceeding.

1.96 A local bankruptcy proceeding may be opened concurrently with a foreign bankruptcy proceeding, resulting in 'parallel' bankruptcy proceedings as to the same entity. In these cases, s 4 mandates that if no international treaty is applied, the foreign bankruptcy proceeding may not be invoked against creditors holding a claim payable in Argentina in order to dispute rights that they may be entitled to

[33] The 1889 Montevideo Treaty has been ratified by Argentine, Uruguay, Paraguay, Peru, Bolivia, and Colombia. The 1940 Montevideo Treaty has been ratified by Argentine, Uruguay, and Paraguay.

claim over local assets or to seek the nullity or avoidance of acts which have been executed against the debtor in Argentina.

1.97 In addition, in the event of a local bankruptcy liquidation proceeding, the Bankruptcy Law requires that a foreign claim 'belonging' to a foreign bankruptcy proceeding be subordinated in Argentine proceedings, and may collect only on remainder assets, if any. Although the precise scope of the term 'belonging' to a foreign proceeding is not clear, the intention of the legislator seems to be that foreign claims admitted in a foreign bankruptcy proceeding (but not others foreign claims) shall be subordinated on the local bankruptcy liquidation proceeding.

1.98 Notwithstanding this priority of the local bankruptcy proceeding vis-à-vis the foreign bankruptcy proceeding as to the proceeds obtained from the sale of local assets, the Bankruptcy Law does not discriminate against foreign creditors. In fact, the few articles of the Bankruptcy Law related to international aspects of a bankruptcy proceeding refer to foreign claims and not to foreign creditors. The place of payment differentiates between foreign and local claims. Foreign claims are payable outside Argentina, while local claims are payable in Argentina. Nationality or domicile of the creditor is not relevant to determine whether a claim should be regarded as local or as foreign.

1.99 This issue is important in the process of a claim being admitted in the debtor's prepetition liabilities. When filing a proof of a foreign claim (ie, a claim payable outside Argentina), the creditor may produce evidence of non-discrimination, showing that a local claim (payable in Argentina) may be recognized, accepted, and eventually paid in an insolvency proceeding in the country where the foreign claim is payable on the same conditions as a claim local to that jurisdiction.

1.100 This requirement, known as the 'reciprocity test' can be satisfied by providing a legal opinion by a lawyer admitted in the jurisdiction where the claim is payable, or with a translation of the foreign bankruptcy law. Recently, courts have softened this requirement by accepting as evidence of the 'reciprocity test' prior decisions from other local courts, which have concluded that certain jurisdictions do not discriminate vis-á-vis |claims payable in Argentina.[34] Security interest claims (*'créditos con garantía real'*) are not obliged to comply with the 'reciprocity' test.

1.101 Finally, s 4 of the Bankruptcy Law includes a provision similar to the 'hotchpot rule', mandating that any monies collected abroad by unsecured creditors after the opening of a local bankruptcy proceeding shall be imputed to the dividend corresponding to such unsecured creditors in the local bankruptcy proceeding.

[34] *'Banco Suquía S.A. s. concurso preventivo'*, Judge Martinez de Petrazzini, Court nro 39 of 'Companies and Bankruptcy' ('Sociedades y Concursos') of Cordoba, decision nro 273, 29 August 2003; *'Sabate Sas S.A. c. Covisan S.A. s. concurso preventivo s. verificación tardía'* (Mendoza Supreme Court of Justice, 28 April 2005).

1.12. Group of companies filing in a foreign bankruptcy court

1.102 Bankruptcy law matters are considered as matters of public order under Argentina law. Section 3, para 3 of the Bankruptcy Law states that the bankruptcy proceeding of a private entity regularly incorporated must take place before the Argentine court corresponding to the company's domicile. This rule will be applicable notwithstanding the fact that the local company is a member of an international group of companies, controlled by a foreign domiciled parent company.

1.103 If the parent company is domiciled in a jurisdiction which admits a joint filing, and one of the subsidiaries included in the filing is an Argentine domicile company, it is uncertain that the Argentine courts would recognize the decisions adopted by the foreign bankruptcy court related to the local domiciled subsidiary and the assets located in Argentina. In a case like this, it is likely that a local creditor would petition the bankruptcy of the local company before the Argentine bankruptcy courts and the local company would end up in bankruptcy before the Argentine courts.

1.104 As mentioned, s 4 of the Bankruptcy Law provides that the opening of a bankruptcy proceeding in a foreign country is sufficient evidence to justify the opening of a local bankruptcy proceeding in Argentina, at the request of the local debtor or of a creditor holding a claim payable in Argentina. Therefore, the filing of a local Argentine company as a debtor in a foreign country may very well cause the immediate opening of a local bankruptcy proceeding, which will prevail over the assets of the local company situated in Argentina. In effect, unless an international treaty is applied, the foreign bankruptcy proceeding may not be invoked against such creditors holding a claim payable in Argentina in order to dispute rights over local assets, or to seek the nullity or avoidance of acts which have been executed with the debtor.

1.105 This raises the question of how the Argentine rules would treat financing provided to a group of insolvent companies filing bankruptcy in a foreign court? As noted above, if the foreign filing involves only foreign companies which have no assets in Argentina, then the Argentine courts should not be involved. On the contrary, if the foreign filing involves a local company (ie a company domiciled in Argentina) or a foreign company with assets located in Argentina, then a local bankruptcy proceeding may be initiated in Argentina at the request of the debtor or of a creditor holding a claim payable in Argentina ('*local creditors*') affecting the debtor's assets located in Argentina.

1.106 In this case, based on the above referenced rule providing that the foreign bankruptcy proceeding may not be invoked against creditors holding a claim payable in Argentina in order to dispute their rights over the local assets, Argentine courts may not recognize a priority claim of a foreign lender backed by a foreign court order if the lien is imposed on the assets of an Argentine corporate affiliate.

1.107 A related issue is whether an Argentine debtor company's foreign affiliate that provides post-commencement financing from its operating revenues to the Argentine affiliate in bankruptcy reorganization, could obtain a special priority lien over the Argentine affiliate's assets. This would only be possible if a petition for a special priority lien over the debtor's assets were authorized by the Argentine bankruptcy court in accordance with s 16 of the Bankruptcy Law. Section 16 of the Bankruptcy Law requires court approval prior to a debtor entering into any act outside the ordinary administration of the company's business, or which is related to registered assets, as is the case with the granting of a lien or a security interest. In deciding whether to grant the authorization, the court must consider the benefits of the act towards the debtor continuing activities and the protection of the creditors' rights.

1.108 In the particular case of post-commencement financing granted by a parent company, the parent company and the debtor will have to convince the court that the benefits derived from the financing outweigh the potential drawback of imposing a security interest on the Argentine debtor's assets.

1.109 Without court approval, any such security interest would be null and void under Argentine law and the bankruptcy court may decide to remove the debtor company's directors, who would also face the risk of liability actions.