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## Latin America Update

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### Laboring in Pain

#### Excessive Protection of Labor Interests under Argentine Insolvency Law



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The Argentine Insolvency Law (AIL)<sup>1</sup> provides for three types of court-supervised proceedings for financially distressed companies, including (1) a *concurso preventivo*, which reflects features that are similar to a traditional chapter 11 case under the Bankruptcy Code (the “*Concurso*”); (2) an *acuerdo preventivo extrajudicial*, which is analogous to a “prepackaged” chapter 11 case; and (3) a *quiebra* (or liquidation proceeding), which resembles a chapter 7 case. The *Concurso* will be the main focus of this article. After outlining a number of the *Concurso*'s key features, this article will discuss the negative impact that overprotection of labor-related claims is having on the ability of debtors to reorganize successfully under the *Concurso*.

#### Public Policy Underlying *Concurso*

The *Concurso*'s goals include (1) the reorganization of a debtor's business in order to avoid liquidation; (2) the development of a reorganization plan for the payment of creditors' claims; and (3) the emergence of the company from the *Concurso* as a viable financial and organizational entity.

#### Commencement of the *Concurso*

A company that is unable to meet its obligations on a regular basis is eligible to request the commencement of a *Concurso* by filing a petition and supporting documents with the bankruptcy court in Argentina. Unlike chapter 11, the filing of these documents does not automatically commence the *Concurso*. Rather, the judge in the Argentine bankruptcy court assigned to the case can either reject or accept the opening of the *Concurso*. The judge must pronounce a judgment within five days of the filing of the request for the *Concurso*, provided that the

debtor has complied with the submission of information and documents required by the AIL.

The judge may reject the opening of the *Concurso* on any of the following grounds: (1) the debtor does not fall within the types of statutory entities that qualify to file a *Concurso*; (2) the petition does not fulfill the legal requirements; (3) the debtor has been subject to a prior *Concurso* and less than one year has elapsed from either the date (a) on which the debtor was declared to have fulfilled the terms of its prior plan of reorganization,<sup>2</sup> or (b) when the debtor's prior reorganization proceeding was dismissed, abandoned or not ratified and the debtor has pending involuntary petitions against it;<sup>3</sup> and (4) a lack of jurisdiction.

#### Notice to Creditors

The Argentine bankruptcy court's resolution approving the opening of the *Concurso* must be published for five days by means of a legal notice in a newspaper designated by the Argentine bankruptcy court and in the Official Gazette, as well as any other newspaper that the judge may consider necessary. In addition, the bankruptcy trustee (defined below) must send a letter to each creditor identified by the debtor in its petition notifying them of the case.<sup>4</sup>

#### Automatic Stay

Upon the opening of the *Concurso* by the judge, the AIL imposes an automatic stay, which stays all other actions or proceedings against the debtor or its property during the pendency of the *Concurso*. However, secured creditors holding privileges (*i.e.*, mortgages or pledges) as security

<sup>2</sup> A.I.L. § 59.

<sup>3</sup> A.I.L. § 31.

<sup>4</sup> A.I.L. § 29.

<sup>1</sup> Act No. 24.522 of July 20, 1995, as amended.

for their claims might be excepted from the stay if they follow certain statutory requirements under the AIL. For example, secured creditors may foreclose on a mortgage or pledge provided that they first file a proof of claim with the bankruptcy trustee.

## Bankruptcy Trustee

Although the debtor, through its board of directors and management, continues in the possession and administration of its property and the operation of its business during the *Concurso*, the debtor is assisted in this process by at least one — and as many as three — accounting firms appointed by the Argentine bankruptcy court to act as *síndico*, or trustee(s) (each called a “bankruptcy trustee”).<sup>5</sup> The bankruptcy trustee is chosen from a list of accounting firms authorized for this purpose by the National Court of Appeals in Commercial Matters (hereinafter, the “court of appeals”), which is the court of appeals for review of decisions by the Argentine bankruptcy court. The number of bankruptcy trustees appointed in a particular case is at the discretion of the judge, who will consider factors such as the number of creditors, the claim amounts and the complexity of the reorganization.

The duties of the bankruptcy trustee include filing monthly operating reports with the Argentine bankruptcy court, which include a statement of income and expenditures for the debtor company, and a report of any facts that might jeopardize the reorganization. The bankruptcy trustee also oversees the claims-filing and allowance process. If requested by the judge, the bankruptcy trustee may perform a liquidation analysis in connection with the process to confirm the reorganization plan to ensure that nonconsenting creditors, if any, receive a distribution under the plan on account of their claims in an amount that is at least as much as they would have received in liquidation. In addition, transactions outside the ordinary course of business require the prior approval of the Argentine bankruptcy court, which solicits the input of the bankruptcy trustee.

## Committees

Until certain amendments were made to the AIL during 2011, a provisional creditors’ committee was created upon the opening of a *Concurso* that was comprised of representatives of the creditors holding the three-largest unsecured claims as reported by the debtor. As a result of the 2011 amendments, both the name and composition of this committee have changed. It is now called the “provisional control committee,” and in addition to the three creditors’ representatives, it includes a representative of the debtor’s workers — regardless of whether such workers have any claims against the debtor in the *Concurso*. The basic purpose of the provisional control committee is to oversee the reorganization process to ensure that the debtor is not wasting assets that should go to creditors, as well as to investigate certain transactions and generally act as a watchdog. The provisional control committee is later replaced by the control committee (defined below), which is appointed when the debtor proposes its reorganization plan.

## Claims Process

All creditors must file claims with the bankruptcy trustee. The judge fixes the deadline for creditors to file proofs of claim in the judge’s order opening the *Concurso*. A proof of claim must state the amount of the claim being asserted, the grounds or basis of the claim, and whether the claim is secured by a mortgage or pledge (referred to as a “privilege”) over the particular property involved. The submission of the proof of claim tolls the statute of limitations and prevents the termination of the action by lapse of right or time.<sup>6</sup>

In the order opening the *Concurso*, the judge also sets a deadline by which the debtors and any creditors must lodge objections to proofs of claim (10 days after the deadline for creditors to file proofs of claim<sup>7</sup>). The objections are submitted directly to the bankruptcy trustee; if no objection is asserted to a claim, the claim is deemed to be “verified.” If an objection is lodged with respect to a claim, the claim may nonetheless be “admitted” over the objection.

The bankruptcy trustee is required to review the claims and objections to the claims and submit a report on the claims to the Argentine bankruptcy court (called the “individual report”). Where a claim is the subject of an objection, the trustee is required to submit a copy of the objection to the Argentine bankruptcy court, together with a report regarding each request for verification of claim that includes an opinion as to the legal basis of the claim and its privilege, if any. Thirty days after the bankruptcy trustee has filed its individual report, the bankruptcy trustee must also issue a general report, which includes a general description of the debtor’s assets and liabilities, and lists the grounds for the debtor’s economic distress.

## Reorganization Plan/Exclusivity Period

Following the judge’s order resolving any objections to proofs of claim, the debtor must submit to the bankruptcy trustee and the Argentine bankruptcy court a proposal for classifying creditors’ claims. The classification must be grounded and reasonable. The grounds for separately classifying claims are: (1) the amount of the claim, (2) the nature of the claim and (3) the character of the claim (*i.e.*, whether it is secured or unsecured). There is also a minimum of three categories: secured, labor unsecured and unsecured. A potential fourth category of subordinated claims exists but rarely appear in AILs.

The AIL recognizes three types of priority claims. The highest in priority are the “special preferred” claims and consist of certain “statutory priority” and “secured” creditor claims.<sup>8</sup> The statutory priority (called “special preferred”) claims include, among others: (1) expenses for the construction, improvement or conservation of something; (2) claims for wages or salary accrued during the six months prior to the bankruptcy filing and those claims arising from indemnities for work-related accidents or dismissal; and (3) taxes. The secured claims are “privileged” claims (*i.e.*, those secured by a mortgage or pledge).

Next among the priority claims are the administrative claims (*gastos de administración y justicia*) that arise dur-

6 A.I.L. § 32.

7 A.I.L. § 34.

8 A.I.L. § 241.

5 A.I.L. §§ 67 and 253.

ing the *Concurso*.<sup>9</sup> Finally, there are the so-called “general preferred” claims, which consist of labor claims, tax claims, Social Security claims, etc.<sup>10</sup>

The key difference between “special preferred” and “general preferred” claims is that special preferred claims attach to certain assets (*e.g.*, specific collateral), while general preferred claims only have priority over the total remaining assets of a debtor after full satisfaction of the special preferred claims and administrative expenses. Equityholders are not impacted by the *Concurso* and retain their interests in the debtor unless they voluntarily agree to a different treatment.

Within 10 days of the expiration of the last day to object to the general report, the judge issues a resolution definitively establishing the categories of claims under any proposed reorganization plan. In the resolution, the judge also appoints the members of a control committee, which replaces the provisional control committee. The control committee is comprised of (1) one member from each class of creditors impacted by the reorganization plan,<sup>11</sup> (2) the workers’ representative who previously sat on the provisional control committee and (3) one or two additional worker representatives.

The judge establishes the period of exclusivity of the *Concurso* (the “exclusivity period”), during which the debtor has the exclusive right (and obligation) to propose a reorganization plan to each class of creditors. The period is fixed by order of the Argentine bankruptcy court and cannot be a date that is greater than 90 days from the date of issuance of the resolution definitively establishing the categories or classes of creditors (the exclusivity period can be extended for an additional 30 days in complex cases). The proposals must be submitted to the creditors and the judge at least 20 days before the expiration of the exclusivity period.<sup>12</sup> The treatment of creditor claims within each class must be the same.

In order for approval of a *Concurso* to be granted by the Argentine bankruptcy court, certain specified majorities of unsecured creditors must consent to the terms of the reorganization plan on a class-by-class basis, as a whole: (1) an absolute majority (*i.e.*, more than 50 percent) of all unsecured creditors, determined on a headcount basis, regardless of principal amount of unsecured debt held (the “headcount majority”); and (2) at least two-thirds of the aggregate principal amount (plus accrued but unpaid interest) of unsecured debt (the “principal majority”).<sup>13</sup>

Once the proposed plan is approved by the requisite headcount and principal majorities, the judge will conduct a substantive review of its terms. If the debtor meets other statutory requirements, the Argentine bankruptcy court will approve the reorganization plan, and the plan terms are applicable to non-consenting unsecured creditors (*i.e.*, cramdown).

## The Challenge of Labor Claims

Under the AIL, the holders of labor claims have certain advantages over other creditors in a *Concurso*, and

this overprotection of labor claims is also making it difficult for debtors to reorganize under the AIL. As previously described, the control committee is dominated by the workers’ representatives, regardless of whether they have claims against the debtor. Moreover, the Argentine Supreme Court ruled in 2014 that general preferred labor claims have priority over other general preferred claims (more specifically, over tax and Social Security claims). In addition, a debtor must make distributions to the holders of labor claims during the *Concurso* (*i.e.*, prior to confirmation of the reorganization plan), whereas all other creditors must wait until after confirmation of the reorganization plan to receive distributions.

Furthermore, the procedural rules require that distributions on labor claims (which can be quite large) occur very early in the *Concurso* (the so-called “prompt payment”), and therefore, such distributions often severely hamper a debtor’s ability to have the necessary “breathing spell” from its creditors. For example, the AIL requires that a debtor devote any and all funds in excess of certain operating expenses (termed the “disponibilities”) toward paying labor claims. As a result, the debtor’s cash flow takes a big hit when it is particularly vulnerable, and the debtor itself may not be able to remain a viable business over the long term because resources that could have been used to revitalize the business (*e.g.*, upgrading the efficiency of a facility) must go toward paying labor claims. As a result, debtors are finding it increasingly difficult to continue operating during an AIL.

Second, as a result of decisions of the Argentine bankruptcy courts and the 2011 amendments to the AIL, a debtor is obligated to pay interest on labor claims until the holders of such claims actually receive their distributions. On the other hand, the accrual of interest on all other types of claims subject to the *Concurso* stops upon the filing of the case. Thus, debtors are further burdened financially during the *Concurso* by having to pay both principal and interest on labor claims.

Third, the AIL originally provided that the opening of a *Concurso* operates to suspend enforcement of labor collective-bargaining agreements (CBAs) applicable to employees of the debtor for the earlier of three years or the end of the *Concurso*. During the suspension of such CBAs, the affected employees are regulated by a different set of rules, which are generally helpful to the debtor during its attempt to reorganize. In 2011, however, the Argentine government repealed this portion of the AIL. As a result, the CBAs operate in full force during the *Concurso* and may not be renegotiated, modified or extinguished due to the reorganization proceeding. As a result of this change to the AIL, debtors have absolutely no flexibility to readjust their often-substantial CBA-related obligations through a *Concurso*.

## Conclusion

Although the *Concurso* offers financially distressed businesses the opportunity to restructure their finances and operations, the excessive deference to labor is hampering the effectiveness of the AIL because the 2006 and 2011 amendments focused almost exclusively on overprotecting

9 A.I.L. § 240.

10 A.I.L. § 246.

11 A.I.L. §§ 41 and 42.

12 A.I.L. § 43.

13 A.I.L. §§ 45 and 45.

labor-related claims, thereby distorting the delicate negotiating equilibrium that must exist between a debtor and all of its creditors during a *Concurso*. This problem could be resolved, in large part, if Argentina were to revert to the pre-2006 statutory version of the *Concurso* with respect to labor-related claims, which would restore the important equilibrium to reorganizations by permitting (1) debtors to undertake the “prompt payment” of labor claims during the *Concurso*, but only after debtors paid the regular post-filing expenses incurred by their businesses (including capital improvements); (2) the suspension of interest accrual on labor claims during the *Concurso* (just like the suspension of interest on other types of claims); and (3) debtors the ability to negotiate temporary collective-bargaining agreements with their workers that would provide both short- and long-term benefits for all interested parties. With a new government just elected in Argentina, a newfound opportunity now exists for Argentina to make these necessary changes to the AIL. [abi](#)

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