



Telecom Argentina: Argentina's largest Restructuring and Cross Border Insolvency Case

by Santiago Carregal¹

This memorandum will discuss the most relevant aspects of the US\$ 3.3 billion financial debt restructuring of Telecom Argentina S.A. ("**Telecom Argentina**"), the largest private debt restructuring in Argentina's history².

Background

Telecom Argentina, a major telecommunications company, completed in late 2005 a restructuring of its financial debt, including debt in the form of notes (*obligaciones negociables*) publicly placed in the United States, Argentina and Europe (**the "Old Notes"**), through an *Acuerdo Preventivo Extrajudicial* (**the "APE"**) and obtained the final judgment of an Argentine court that approved the APE in an Argentine insolvency proceeding (**the "Argentine Judgment"**), under which the APE became enforceable against all unsecured creditors, including those that did not consent it. Although the APE approved by the Argentine Judgment required the cancellation of the old debt, including the Old Notes, upon receipt of the new consideration, the indenture trustee (**the "Indenture Trustee"**) for the Old Notes refused to cancel the Old Notes of holders, including The Argo Fund, Ltd. ("**Argo**"), who had not consented to the restructuring. Telecom Argentina therefore filed a petition in the United States Bankruptcy Court for the Southern District of New York (**the "Bankruptcy Court"**), under Section 304 of the US Bankruptcy Code seeking to obtain recognition of the Argentine Judgment and an order compelling the Indenture Trustee to recognize and comply with the APE and the Argentine Judgment, and to cancel all of the Old Notes. Only Argo objected.

¹ The author is a partner of Marval, O'Farrell & Mairal, Argentina.

² The Telecom Argentina Restructuring obtained the awards "Americas Restructuring Deal of the Year 2005" from Thomson International Financing Review, and "Americas Restructuring Deal of the Year 2006" from the International Financial Law Review.

The Bankruptcy Court granted the Section 304 petition, finding that the final Argentine Judgment, and Telecom Argentina's restructuring agreement, were entitled to comity and to *res judicata* effect, and that Argo, a creditor that chose not to participate in the Argentine insolvency proceedings, could not employ the courts of the United States to engage in a collateral attack of the Argentine Judgment.

The Bankruptcy Court's judgment was affirmed by the District Court.

Argo appealed the District Court's judgment before the United States Courts of Appeals for the Second Circuit, and the appeal is pending resolution.

Description of Facts and Arguments

A. Argentina's Economic Crisis

Telecom Argentina is a *sociedad anónima* organized under Argentine law that provides public telecommunications services in Argentina, in particular, fixed-line local, national and international long distance services, data transmission, and access to Internet service. Through its subsidiaries, it also provides mobile telecommunications services in Argentina and Paraguay.

In late 2001, the economic environment in Argentina deteriorated, and in the first six months of 2002 the Argentine peso, which had been pegged to the U.S. dollar for more than 10 years, was devalued and permitted to float freely. In addition, Argentina promulgated laws³ that converted the rates at which Telecom Argentina was paid into pesos, and prohibited increases in such rates. As of December 31, 2001, Telecom Argentina was the obligor on approximately US\$3.3 billion of debt on a consolidated basis, including both Old Notes and debt issued under various credit agreements in the United States and elsewhere.

As a result of the deterioration of the economic environment in Argentina, the exchange rate between pesos and dollars was approximately 3 to 1 during the first half of 2002. Since Telecom Argentina's debt was denominated in currencies other than pesos, including US Dollars, Euros and Yens, Telecom Argentina faced a liquidity crisis and during the first half of 2002 was forced to suspend principal and interest payments on all of its debt. On February 27, 2002, Telecom Argentina hired Morgan Stanley & Co. Inc. and MBA Banco de Inversiones S.A. as its financial advisors to develop a comprehensive plan to restructure its debt, including the Old Notes.

³ Among others, the Emergency Law 25,561 promulgated in January 2002.

Thereafter, Telecom Argentina commenced a process, at first informal, to negotiate a restructuring of its outstanding \$3.3 billion of debt. No agreement was reached, so on January 9, 2004, Telecom Argentina announced that it would seek approval of its own proposal pursuant to an APE⁴. An APE is an insolvency proceeding, very similar to a prepackaged plan of reorganization under the U.S. Bankruptcy Code, and is governed by provisions of the Argentine Bankruptcy Law enacted to address the Argentine economic crisis.

Because Telecom Argentina's debt was held by investors in several countries, Telecom Argentina conducted its solicitation of consents to the APE proposal pursuant to regulations applicable to public offerings in Argentina, the United States and Italy. Telecom Argentina filed a registration statement describing the APE proposal with the U.S. Securities and Exchange Commission ("SEC"), and this registration statement, as well as subsequent press releases and modifications, were reviewable on the SEC's EDGAR website. A similar solicitation statement was filed with Argentine and Italian securities regulators.

After extensive negotiation, Telecom Argentina and its creditors reached agreement upon a restructuring proposal, and a final solicitation statement was filed with the U.S. Securities and Exchange Commission, with the *Comisión Nacional de Valores* in Argentina and with the *Comissione Nazionale per le Società e la Borsa* in Italy, on July 9, 2004. The widely publicized proposal gave each consenting creditor three options for repayment, with recoveries ranging from 80.3% to 100% of the outstanding principal face amount of their claims, plus an adjustment factor for interest.

On August 23, 2004, Telecom Argentina announced that approximately 94.4% in principal face amount, or approximately 82.4% in number, of the holders of Old Debt had consented to the APE proposal.

⁴The APE is an out-of-court debt restructuring agreement that is binding on all unsecured creditors of the debtor company, including those that did not consent to the APE, provided that: (i) the APE is signed by the majority of creditors provided by the Argentine Bankruptcy Law ("ABL") (more than 50% of all unsecured creditors representing at least 2/3 of the outstanding unsecured debt); and (ii) the court endorses or validates the signed APE (under the ABL, this court ruling is denominated an *homologación*, which basically consists of a judicial confirmation that the APE complies with the ABL legal requirements). Votes on the APE restructuring agreement are solicited prior to any filing for court approval. The filing of the APE before the relevant court has the effect of staying all actions to enforce unsecured claims against the debtor. However, it does not suspend the accrual of interest on outstanding debt. The court will conduct a review of the compliance of the required majorities and other formal requirements, and a limited review of the substantive terms of the APE (for example, to determine that basic standards of Argentine law have not been breached, such as compliance of public order regulations, non existence of fraud, that the proposal is not "abusive" or that it does not discriminate creditors on unreasonable grounds).

B. The Argentine Court Review

On October 21, 2004, Telecom Argentina submitted its APE to the Juzgado Comercial No.19, Secretaria No. 38 of the City of Buenos Aires (**the “Argentine Court”**) to commence the judicial approval process under an APE insolvency proceeding. The Argentine Court conducted a rigorous review of the conduct of the APE, and on the related documentation and information filed, and required repeated and widespread notice to, and oversight of voting by, affected creditors. The Court also ordered a noteholders’ meeting, at which all noteholders participating in person or voting by proxy cast ballots in favor of the APE. In addition, examiners appointed by the Argentine Court reviewed the proxies granted by creditors in order to confirm the majorities achieved and to evaluate the legitimacy of the votes.

C. The Orders and Judgment of the Argentine Court Approving the APE

On February 25, 2005, the Argentine Court accepted the APE as having been validly approved by the requisite majorities under Argentine law, and granted creditors an extensive period to interpose objections. Among the objections filed by creditors that did not consent the APE, two are relevant for the analysis of Argo’s arguments raised before the Bankruptcy Court. One objection claimed that the compensation paid under the APE was less than Telecom Argentina’s liquidation value. Another objection requested that non-consenting creditors be permitted the same payment options as consenting creditors⁵. Both objections were framed in terms of the APE being “abusive”⁶. Argo filed no objection with the Argentine Court and indeed declined to participate at all in the Argentine proceedings.

The Argentine Court ruled that the objection addressed to liquidation value was untimely – but not that it was outside the scope of permissible objections.

⁵ Pursuant to Telecom Argentina’s APE, holders of debt that did not consent to the APE or voted against the APE would have their debt allocated into option A (an option that provided a par recovery at lower interest rates).

⁶ Non-consenting creditors have the right to contest the APE on limited grounds, such as omissions or exaggerations of the assets or liabilities, non compliance of the required majorities, or non compliance of the other formal or substantive requirements (for example, that basic standards of Argentine law have been breached, such as compliance of public order regulations, existence of fraud, existence of abusiveness in the proposal, discrimination against one or more categories of creditors, etc.).

The Court however granted the other objection, ordering Telecom Argentina to offer non-consenting creditors the same payment options as consenting creditors.

Finally, the Court ruled that Telecom Argentina, in light of its “business crisis,” had appropriately invoked the Argentine APE law and had met its requirements:

“In respect of the proposal made, taking into consideration the restructuring sought as a means of turning around the business crisis, the elements provided to the case by the debtor and those required by the Court, such proposal does not appear to be abusive, fraudulent or discriminatory in accordance with the applicable legal regulations.”

No appeal was filed, and the Argentine Judgment became final.

D. The Closing of the Debt Restructuring

The debt restructuring pursuant to the APE approved by the majority of the creditors and by the Argentine Court under the APE proceedings closed on August 31, 2005. The required consideration was delivered to consenting holders, and their Old Notes were cancelled. The consideration owing to non-consenting holders, who then held approximately US\$80 million of the over US\$1.6 billion of Old Notes, was paid into a trust. On December 14, 2005, the Argentine Court declared the APE fulfilled and closed the proceeding.⁷

E. The Indenture Trustee’s Refusal to Cancel Old Notes

The APE required that all of the old debt be cancelled upon receipt of consideration by creditors. However, the Indenture Trustee refused to cancel Old Notes held by non-consenting holders unless ordered to do so by a United States court. Telecom Argentina was therefore required to file the Section 304 Petition (the “304 Petition”)⁸.

⁷ Since the Closing, every creditor other than Argo has agreed to the terms of the APE, has collected payment, and has accepted cancellation of its Old Notes. Argo has also been paid. The parties have agreed that this appeal may proceed solely to determine whether Argo is entitled to any additional payment.

⁸ Section 304 sets forth certain criteria to be considered in connection with a decision to grant recognition to a foreign proceeding. On the appeal, only one, comity, is at issue.

Section 304 of the Bankruptcy Code is not applicable to cases filed after recent amendments to the Bankruptcy Code were enacted. This Section 304 petition was filed before that date, and therefore Section 304 remains applicable.

F. The Section 304 Petition

On September 13, 2005, the Board of Directors of Telecom Argentina filed its verified 304 Petition, together with supporting declarations, in the United States Bankruptcy Court for the Southern District of New York, seeking an order compelling the Indenture Trustee to recognize and comply with the APE and the Argentine Judgment, and to cancel all of the Old Notes.

Argo and the Indenture Trustee were given notice of the petition. Neither the Indenture Trustee nor any other entity opposed the 304 Petition. Only Argo filed an answer objecting to the relief sought by Telecom Argentina.

G. Argo's Motion to Withdraw the Reference

Argo moved to withdraw the reference of the case to the District Court, on the grounds that consideration of Telecom Argentina's petition would require substantial and material consideration of the Trust Indenture Act of 1939 ("**Trust Indenture Act**"). In support of the motion Argo filed the affidavit of a purported expert, who claimed that Telecom Argentina was able to pay its creditors in full.

The District Court (Scheidlin, D.J.) denied the motion to withdraw the reference. The Court concluded that the application of the Trust Indenture Act, if relevant at all, would be a routine matter, and held that the real question was whether the requirements of Section 304 had been met, a matter squarely within the expertise of the Bankruptcy Court.

H. Telecom Argentina's Motion *In Limine* to Exclude Evidence

A trial date was then set in the Bankruptcy Court. Prior to the trial, Telecom Argentina moved *in limine* to prevent an attack upon the Argentine Judgment by introduction of evidence addressed to Telecom Argentina's ability to pay⁹. On November 22, 2005, the Bankruptcy Court granted the motion.

I. The Trial In the Bankruptcy Court

Trial was held before the Bankruptcy Court on December 12, 2005. Argo framed the issue as follows:

⁹ Testimony of Prof. Israel Shaked.

[Argo's counsel]: "Here we have a creditor that says I should be receiving more, and we have evidence that shows that indeed not only more could be paid, but a hundred percent plus could be paid."

"This objection couldn't be made in Argentina."

Telecom Argentina offered in evidence the written testimony of Mr. Pablo Caride, Telecom Argentina's Finance Director, which addressed both the need for restructuring, and the chronology of the Argentine proceedings. Mr. Caride was not cross-examined, and no evidence was offered to contravene his evidence. Telecom Argentina also offered the testimony of an expert on the Argentine Insolvency Law, Dr. Javier Lorente.

Dr. Lorente testified that an APE proceeding is an insolvency proceeding that an entity need not be insolvent but only in general financial difficulty to be eligible to file an APE proceeding, and that a creditor may object to confirmation of an APE on the grounds of abuse or fraud. Indeed, even an entirely consensual APE may not be approved unless the Court has found that it is not abusive or fraudulent.

Dr. Lorente testified that the concept of "abuse" brings in many areas of the law and so affords a wide scope for objections, including the objection that a debtor could have paid more. He observed that one creditor had actually objected that the company could "pay more" in liquidation.

Dr. Lorente testified that the Argentine Court would have permitted Argo to object that it would have received more in liquidation, and to put in evidence on the point. He said that the "abusiveness concept includes liquidation value".

Dr. Lorente testified that the Argentine Court had exercised supervision over those proceedings; that the APE law and Telecom Argentina's APE proceeding "provided creditors, including Argo, with a full and fair opportunity to assert objections to the APE, and that these objections were considered in a meaningful way by the Argentine Court".

Dr. Lorente also testified that the Argentine Judgment is *res judicata* in Argentina; that if a United States court required Telecom Argentina to pay in full on its Old Notes, in violation of the APE confirmation, the company could immediately be liquidated; that if Telecom Argentina had lost its operating license, it would have lost its business; and that the consideration paid by Telecom Argentina was the best ever paid in an APE .

Argo called Dr. Julio Cesar Rivera, its Argentine law expert. Dr. Rivera agreed that an APE proceeding was an insolvency proceeding, that an entity need

not be insolvent to invoke the process, and that creditors were treated equally by the Argentine Judgment.

Dr. Rivera agreed that creditors can make all kinds of arguments in the context of alleging abuse or fraud.

Dr. Rivera also agreed with Dr. Lorente that an “abusive” APE could not be confirmed by an Argentine Court. He agreed that creditors could raise the argument that a debtor could pay more, although he testified that this argument should be framed in the form of a “*denuncia*”, not as an objection. He specifically agreed that a creditor could claim as “abusive” that liquidation value is higher than what is proposed in an APE, and that Argentine courts have requested evidence regarding liquidation value.

Finally, Argo submitted evidence that confirmed its continuing acquisition of Telecom Argentina Old Notes (and new debt securities) throughout the APE process.

J. The Bankruptcy Court’s Recognition of the Argentine Judgment

On February 24, 2006, Bankruptcy Judge Lifland issued his Order and Judgment, supported by extensive Findings and Conclusions. The Bankruptcy Court discussed the evidence in detail, found that each of the elements of Section 304 had been met, and granted the Section 304 petition.

The Court concluded, as relevant on this appeal, that the concept of “abusiveness” is defined broadly under Argentine law.

“[T]he evidence demonstrates that Argo could have objected to Telecom Argentina’s eligibility to file its APE, as a pre-confirmation objection, and to the fairness or abusiveness of the substantive provisions of the APE, in connection with confirmation.”

The Bankruptcy Court determined that “whether a debtor could pay more could be raised in an objection,” and that Argentine courts had, in that connection, requested evidence of liquidation value: “[T]he Argentine Court would not have confirmed the APE if the Court had found that the APE exceeded the limits imposed by good faith, ethics, and morals.” The Court acknowledged that if a court in the United States were to compel Telecom Argentina to take action inconsistent with the Argentine Judgment, the company could be placed into immediate liquidation. The Court ruled that the ability to pay more was no bar, and adherence to the Trust Indenture Act no prerequisite, to a grant of comity.

Finding that the Argentine Court had held that the APE was an appropriate response to the business crisis faced by Telecom Argentina, the Bankruptcy Court held that comity was especially appropriate here:

“Comity is therefore especially appropriate where, as here, the Argentine Court has issued a final judgment that the APE meets the requirements of Argentine Insolvency Law, and that judgment is final and binding on all affected creditors as a matter of Argentine law.”

K. The District Court’s Affirmance

Argo appealed the Bankruptcy Court’s Judgment. Most of the issues raised at trial, such as whether an APE proceeding was an insolvency proceeding, were dropped on the appeal. Argo’s main focus was that the Section 304 petition should have been denied because the Argentine Court would not have considered the objection that Telecom Argentina could have paid more in liquidation, and that the Argentine Judgment was repugnant to United States law because it did not require, *sua sponte*, a liquidation analysis to assure that every creditor would receive as much in the APE as in liquidation, as required by Section 1129 of the Bankruptcy Code.

On November 17, 2006, the District Court (Buchwald, D.J.) issued its judgment affirming the Bankruptcy Court’s ruling. After reviewing the grant of comity under an abuse of discretion standard, the District Court affirmed the Bankruptcy Court’s Judgment.

The Court held that both experts had agreed that “creditors may object on various grounds,” including that an APE is abusive or fraudulent, and “that an objection that a debtor could have paid more in a liquidation would fall within the scope of permissible objection.” Therefore, Argo could have raised its objection to approval of the APE.

“[W]e find Dr. Lorente’s testimony, as corroborated by Dr. Rivera’s, to clearly demonstrate that under Argentine law, creditors are entitled to raise objections to confirmation of an APE based on liquidation value. As such, there were no ‘formal or jurisdictional or statutory barriers’ which precluded appellant from raising its objections in the APE proceeding.”

Observing that *res judicata* is not “predicated on a determination that the original court need have granted the possible claims; rather, it is sufficient that the claimant had the opportunity to properly raise his objections,” the District Court held that *res judicata* precluded Argo from raising the objection for the first time in a United States court.

The District Court had recognized that the *res judicata* and comity analyses are linked, and found that comity is usually granted where a foreign court had jurisdiction and enforcement of its order does not prejudice the rights of U.S. citizens or violate U.S. policy. Judge Buchwald rejected Argo’s contention that these principles should not govern this case. The Court adopted Judge Scheindlin’s earlier ruling that the Trust Indenture Act was no bar to a grant of comity under Section 304, and held that the failure of Argentine law to adopt the conditions to confirmation set forth in Section 1129 of the Bankruptcy Code was no bar to recognition: “[L]ack of a best interests analysis does not necessarily preclude recognition of a Section 304 petition.” Thus, the Court rejected Argo’s claim that the APE was fundamentally unfair as a consequence of the failure to adhere to U.S. law. Finally, Argo’s evidentiary objections were deemed moot.

L. The Appeal To The United States Court of Appeals For The Second Circuit

Argo has appealed the District Court decision. Argo contends that under the Trust Indenture Act and the “best interests” test Argo is entitled to payment in full, and therefore the Argentine Judgment is not entitled to comity. Argo argues that it was denied the ability to object to approval of the APE on the grounds that Telecom Argentina could have paid more, and that the failure of the Argentine Judgment to adhere to the Trust Indenture Act and the “best interests of creditors” test under the Bankruptcy Code renders it repugnant to United States law and policy.

Telecom Argentina argues that the District Court decision should be affirmed because comity was appropriately granted to the Argentine Judgment; it is *res judicata* as to issues that were or could have been decided by the Argentine Court. The doctrine of *res judicata* precludes relitigation of matters that were, or could have been, raised in the Argentine Court. Therefore, the Bankruptcy Court’s exercise of its discretion to deny discovery, and to preclude expert testimony, relating to Telecom Argentina’s financial state either now or at the time of the APE process, was proper.

Conclusions

Companies in emerging markets accessing the US and European securities markets to obtain financing generally subject their debt instruments to the US laws, including the Trust Indenture Act of 1939. These issuers are sometimes exposed to volatile economic environments which in some cases force them to restructure their debt and seek relief of insolvency laws in their home countries. Because the issuer's debt instruments are governed by US laws, the recognition by the US courts of the final judgment rendered by the foreign insolvency court becomes essential. However, cross border reorganizations of foreign companies present complex issues for the US courts, since in order to merit comity they are required to evaluate the procedural fairness of the laws of another country, laws which sometimes are different from US bankruptcy laws. In both the Multicanal S.A. and the Telecom Argentina bankruptcy court's decisions it was held that the APE laws were entitled to comity. It is critical for ensuring certainty and effectiveness in international financial transactions that foreign insolvency proceedings procedurally fair and sought in good faith, and which do not contravene the laws or public policy of the United States, become recognized by US courts.