
The APE: an institution in trouble

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Almost four years since the enactment of the emergency legislation that amended the Bankruptcy Law and introduced the preventive extrajudicial agreement (*Acuerdo Preventivo Extrajudicial* or 'APE'), it seems that this statute is facing overwhelming criticism that, in the opinion of many, may end its acceptance by the bankruptcy courts.

And the reason to end the applicability of this important tool, which permitted the reorganisation of many companies in Argentina after the crisis of 2001 (with estimated debt restructurings amounting to approximately US\$10,000 million), is basically the abuses that can affect creditors in some cases. It was the legal experts and judges who raised several concerns as to its validity *vis-à-vis* the creditors' rights with regard to the financial distress of the debtor.

In order to bring some clarity to the matter, I will refer to the circumstances in which the APE was introduced. In January 2002, Argentina was immersed in the worst social and economic crisis in its history: there were severe restrictions on the transfer of funds abroad, with the termination of the convertibility regime after one decade of a mandatory exchange rate of one peso per one US dollar, and the impossibility, for many local companies, of honouring debts expressed in foreign currencies. It should be said that many such companies maintained debts in foreign markets due to the opening of the capital market in Argentina during the 1990s.

At the time it was really hard to imagine a worse scenario. The federal government, in a desperate attempt to avoid a waive of judicial claims against local

companies, and even private individuals, introduced the so-called APE for the purpose of settling disputes between creditors and debtors, and avoiding the courts, which could not have provided solutions in the flexible and speedy manner that the circumstances required.

The APE was then introduced by Congress, which through the Emergency Legislation (Law No 25,563 – ‘Productive and Credit Emergency’ and Law No 25,589 – ‘Amendments to the Bankruptcy Act and to Law No 25,563’) made important changes to bankruptcy proceedings. Some of these changes have been explained in previous articles in this newsletter over the last few years.

The APE made it possible to obtain a settlement proposal which, if it received the approval of specified majorities of creditors, as provided by the Law, would become mandatory for all the creditors if it finally obtained judicial approval (*homologación judicial*), despite the fact that not all creditors participated; the lack of bankruptcy trustees who might conduct, and exercise control over, the process and the information provided by the debtor; and the very restricted control and objections that creditors are entitled to exercise during the proceeding.

But the complaint of most of the critics has been the increased risk of fraud since the provision has been incorporated in the Bankruptcy Law. In effect, the reduced control exercised by certain judges; the almost absolute freedom granted to debtors in relation to the terms and conditions of this form of settlement agreement; the limited intervention of the creditors within the proceeding; and the relative value of the information provided to creditors on the situation of the debtor (which by the way is provided almost exclusively by the latter) are circumstances that, unfortunately, facilitate the fraud by the debtor.

In recent months, certain judicial activity – especially on the part of the Court of Appeals Prosecutor – has attracted scrutiny. In effect, in *Lalor SA*¹ the prosecutor has raised doubts as to the constitutionality of the regulation governing the APE under the Bankruptcy Law, since this regulation could affect constitutional guarantees (regarding ownership and equal treatment among creditors). In other cases, debtors exercising their rights, as provided by the Bankruptcy Law, attempted to affect creditors’ rights by discriminating or introducing abusive conditions in the proposal. Furthermore, in some cases many of those creditors did not even participate in the APE but were subject to its terms and conditions, since once it has been judicially approved, it becomes mandatory for all of the creditors.

It should be also said that the opportunities for creditors to object to an APE is restricted, and opportunities are further reduced in cases where the debtor has omitted or exaggerated the accounting information (eg concerned with assets or liabilities),

or due to a lack of the majorities required by law for judicial approval of the proposal.

However, *Lalor SA* is not the first case in which judges have had to decide on the constitutionality of the APE. In *Romi SRL*² the court of appeals faced the objections of a creditor based almost exclusively on eventual abuses by the debtor, who exercised the rights provided by the amended Bankruptcy Law.

Likewise, it is also important to mention that many judges, even though this is not in strict observation of the Law, have unilaterally introduced certain requirements to avoid abuses by the debtor: for instance, the appointment of a trustee (not indicated in the Bankruptcy Law for the APE) or demands for more information than that required by section 72 of the Law. They have done this in an attempt to remedy the omissions and gaps found in the regulation.

Notwithstanding all the aforementioned, for many scholars the APE was, and will continue to be, an important instrument in reorganisations. They admit that after four years, certain adjustments are necessary to maintain the balance between creditors and debtors. But it should be remembered that the APE was introduced when the crisis of 2002 was fragmenting the local economy, helping many companies that would never have survived under the traditional business reorganisation process, and with no real precedents in our legislation. And it is fair to say that the APE was an important solution during that unfortunate period for our economy. Now is time for the legislators to adjust the procedure, and put a stop to abuses by debtors that may bring about the termination of the APE.

Note

- 1 Extrajudicial preventive agreement, Commercial Court of Appeals, Chamber D, 08/18/05.
- 2 Extrajudicial preventive agreement, Commercial Court of Appeals, Chamber B, 10/31/05.