THE SUBPRIME CRISIS AND ITS EFFECT ON ARGENTINA’S REAL ECONOMY

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I. INTRODUCTION

It is worth understanding that the current reduction of growth in Argentina seems to have a more domestic explanation rather than a foreign one.

The 2008 conflict between the Government and the farmers coupled with the nationalization of the private retirement funds “Administradora de Fondos de Jubilaciones y Pensiones (AFJP)” intensified the transfer of capital overseas, which from April 2008 to April 2009, exceeded those produced during the 2001 economic crisis.

In the first quarter of 2009, the gross domestic product (GDP) fell from 5.5% to 3%. The main contribution to its decrease was caused by the private consumption followed by the private investment. The external sector played in favor, given that imports decreased more than exports (“El Cronista” May 22, 2009).

The fiscal surplus plummeted 70% in April 2009. The government argues that it was due to an increase of public spending with the objective to use this variable in a countercyclical manner, that is, to increase the level of activity during a recessive phase of the economic cycle. The
fundamental tool to reach this objective was public works because of its high
multiplicative effect on the level of activity and employment.

A consulting firm concluded that the fall of the
government surplus is not attributable to a premeditated countercyclical policy
but rather to the strong downturn of the revenue and in particular, the
reduction in tax collection.

Nowadays, the government lacks sufficient tools to
overcome the crisis. It did not take advantage of the time of high prices of
agricultural commodities, restricting exports by taxing them with
"retenciones" and intervening in the markets by setting the prices of public
services, energy and basic foods (meat, flour, dairy products, etc.). Those
measures discouraged production and new investments in each sector in
particular. The prices did not increase, which was the objective of the
government; however this policy destroyed the Argentine core business
making the production of grains, meat and some industrialized foods
unprofitable.

The Argentine agribusiness has a striking multiplicative
effect on all the economy, most of all, on that of the provinces, causing the
demand for machinery, automobiles and other consumer goods to decline
remarkably, generating a reduction in shifts, suspensions and early vacations
in factories.

There are also business concerns in relation to the
government’s policy to increase its intervention in the economy by attempting
to appoint members in the board of directors at some large private companies.
The government became shareholder of the companies after the nationalization of the AFJPs (former’s Argentine private pension funds).

Today, it has been four years since Argentina got out of the default declared in January 2002. The restructuring of the sovereign debt reduced it from $191,000 million to $117,000 million.

The holdouts of the swap left Argentina with a $20,000 unsettled debt.

In January 2006, the debt ($9,180 million) with the International Monetary Fund (IMF) was canceled.

After the restructuring Argentina’s debt increased 13.3%, due to the inflation adjustment of one of the series of bonds issued to exchange the old ones. According to the Argentine Secretariat of Finances, at the beginning of 2008, the debt was $144,728 million, higher than the outstanding one at the declaration of default in 2002.

The most serious problem that Argentina faces is the lack of financial resources for investment and consumption and the excessive public spending. The slowdown of the economy has caused the reduction of government revenues that complicates the implementation of Keynes’ theories.

II. RECENT RESTRUCTURING CASES.

We have made a summary of the current economic situation in Argentina for your better understanding of how it can influence the real economy. With this in mind, we will analyze the most important private restructuring cases that took place since the end of 2008.
2.1. The TGN case.

At the end of 2008, Transportadora de Gas del Norte SA, from now on TGN, an important gas pipeline, declared its default. Today, it is offering an exchange of bonds to its creditors and it is implementing an APE (an Argentine out of court proceeding).

It is necessary to briefly explain what the Argentine APE is, before moving forward. The 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 ABL; and (ii) the court endorses or validates the APE executed. Under the ABL, the court’s ruling is denominated an homologación, which basically consists of a judicial confirmation that the APE complies with the ABL legal requirements. (For additional information you can refer to Ricardo W. Beller’s paper “Argentina’s Prepackaged Debt Restructuring Agreement”, presented to the III Conference, New York, June 2004).

The Argentine Bankruptcy Law requires that any debtor who enters into an APE be insolvent or in general financial or economic difficulties. This standard allows the debtor to start its APE at an early stage of the crisis without the burden of showing evidence of insolvency.

The APE has to be filed with the court together with a dossier of documentation referring to the financial situation of the debtor, including among others: (i) an assets and liabilities statement, (ii) a list of creditors, (iii) a list of pending lawsuits and administrative procedures against
the debtor, (iv) the amount of existing indebtedness held by creditors that have executed the APE and the percentage they represent with respect to the total registered debt.

The filing of the APE in Court has a similar effect than the United States Bankruptcy Law automatic stay of actions. Unsecured creditors are not allowed to file actions against the debtor. The rule does not suspend the accrual of interest on the outstanding debt.

What is most important, and the reason why it is an efficient tool to restructure is that upon Court endorsement, the APE becomes effective against all unsecured creditors, including those that were not part of it.

The Obligaciones Negociables –O.N.- issued by TGN (private bonds) were non convertible, be issuer defaulted not only in its interest but also in its principal for a total amount of $350 million.

The company’s proposal was:

i) The issuance of O.N.s (bonds) without acquittance of its face value for an amount equal to the current debt. The due date is in 2021 and the interest rate will be from 2% annual increasing up to 6% annual, and its payment every six months. The payment of the principal will begin in the seventh year of the exchange date and every six months.

ii) One cash payment for a total amount of $30 million prorated between all the creditors that accept the proposal subject to the proceedings described in the company’s offer. This proposal has an aquittance of
75% (for every $1.000 of the outstanding debt, the company will pay $250).

Approximately 50-60% of the creditors are foreign investors located mainly in New York City, New York, USA, where a meeting will be held in the first two weeks of June 2009.

It is important to point out that when TGN declared its default in December 2008, Enargas filed an accusation before the Criminal Court claiming non-regular adoption of the decision.

The government sustained in particular that the minutes of the board meeting were not transcribed in the appropriate book at the time of the public announcement of the default. The Criminal Court dismissed the case. It did not find evidence of any wrongdoing by TGN.

In parallel, the government intervened TGN on December 29, 2008, maintaining directors and officers of the company in their positions. The reason that the government decided to intervene was based on the fact that the default could put the rendering of the public service at risk.

2.2. The Bonesi case.

We decided to analyze this case because it will test the legal regulation of trusts in the framework of a judicial reorganization case (concurso preventivo). Due to the slowdown of the consumption and the nationalization of the AFJPs (pension funds), which were the largest investors of the different trusts that financed the sector, the household appliance chain Bonesi, filed for concurso preventivo (a debtor in possession reorganization similar to US chapter 11).
We have said that the Bonesi case is a test for the validity of the trust under Argentine law, given that there are scholars that challenge the regulation of the trust and confuse its rules (for example, with the ones that regulate the pledge in which the property of the asset stays with the owner or pledgor but the good is delivered in security to the pledgee).

As a result when the settlor later commences a voluntary judicial reorganization (concurso preventivo), the problem arises when the judge has to decide if the assets that were transferred to the trustee belong to the trust like it was determined when it was created, or to the insolvent settlor that has filed for relief.

Bonesi has 41 stores located in the provinces of Buenos Aires, Santa Fe and Entre Rios being particularly relevant its activity in the two latter.

The bonds issued by the trustees for an amount $50.5 million are held by banks, individual and the government agency named ANSES now managing all the Argentine retirement and pension system.

Bonesi organized twenty-two trusts, more than half of them were paid in due time.

After the filing for judicial relief, Bonesi has eight non-performing trusts. When the trusts were created and Bonesi received the funds, the company assigned to the trustee (a bank) the cash flows originated by the payment of the loans given to its clientele. Bonesi was appointed in the trust agreements, as the collector of those cash flows, with the obligation to delivery them to the trustees.
The risk assumed by the investors was minimal because Bonesi financed its clients at an interest rate of 50-60% annually and the bonds issued by the trustees paid only an interest rate of 20% annually.

Bonesi unduly retained the cash flows that had to be delivered to the trustees. That misconduct generated the beginning of investigations by the CNV (an Argentine agency similar to the US SEC) and claims, filed by the trustees at the Bankruptcy Court.

In the reorganization judicial proceeding the Court rejected a trustees petition requesting the Judge to order Bonesi to refrain from collecting the loan granted to its clients, who would paid the installments directly to the trustees.

There is no definite judicial ruling in relation to the $50 million unduly retained by Bonesi but it is obvious that it will not be able to return the money to the trustees because it lacks funds and they need them to maintain the company ongoing. The above mention situation could give rise to the beginning of a criminal investigation for undue retention of third party’s funds.

2.3. The Restructurings of SNIAFA, GASA and SIESA.

In May 2008, SNIAFA, an important textile company, filed for concurso preventivo (a debtor in possession judicial reorganization similar to US bankruptcy law chapter 11). It was the first of the textile sector to use that remedy.
The downturn was exposed in the last financial statements and it was caused fundamentally by the high cost of inputs, the increase in the price of energy and the reduction of sales.

It seems that the restructurings in Argentina this year will be operated by means of an in-court-restructuring instead of what happened in 2002 in which workouts (APE) were more utilized.

GASA filed for judicial reorganization also in May 2008. It is a corporation that controls Metrogas, the gas distributor of the city of Buenos Aires.

The shareholders of GASA are British Petroleum and Repsol YPF.

GASA’s bonds are held by a few investment funds that have commenced involuntary bankruptcy proceedings. Those actions forced GASA to file for judicial reorganization also pressured by the lack of income, because Metrogas did not pay dividends due to the fact that its fares had been intervened by the government and were not enough from the company’s point of view to cover costs plus reasonable profit.

Compañía de Inversiones de Energía S.A.-CIESA-, is the controller of Transportadora de Gas del Sur S.A.-TGS- an important gas pipeline, and has initiated the restructuring of its debt, due to similar reasons as were mentioned concerning GASA. In the CIESA case there is a particular difference from the situation of GASA because all the bonds are held by only one creditor.