

Bondholders of Insolvent Argentine Company Denied Relief by U.S. Bankruptcy Court

ADAM C. DEMBROW

A recent decision by a New York bankruptcy court highlights important practical considerations for investors in foreign companies that commence insolvency proceedings abroad.

In a recent decision, the United States Bankruptcy Court for the Southern District of New York (the “U.S. Court”) exercised its abstention powers and dismissed an involuntary Chapter 11 petition filed against an Argentine company, Compania de Alimentos Fargo, S.A. (“Fargo”).¹ Fargo, a debtor in an insolvency proceeding in Argentina, had moved to dismiss the involuntary petition principally because its Argentine bankruptcy case was still pending.

As a result of the U.S. Court’s ruling, the creditors of Fargo that had initiated the involuntary Chapter 11 case were unable to seek a restructuring of Fargo under United States bankruptcy law, and were relegated to the continued pursuit of relief in the Argentine courts, a forum which they had complained (albeit unconvincingly in the U.S. Court’s view) was treating them unfairly. In reaching its decision, the U.S. Court undertook two related analyses: whether to abstain and dismiss the involuntary petition, and whether to grant comity to the Argentine insolvency proceeding. As discussed below, the decision highlights important practical consider-

Adam C. Dembrow, an attorney in the New York office of Cadwalader, Wickersham & Taft LLP, can be reached at adam.dembrow@cwt.com.

ations for investors in foreign companies that commence insolvency proceedings abroad.

RELEVANT BACKGROUND

Fargo and its five wholly owned subsidiaries constitute Argentina's largest commercial producer and packager of bread and bread products. All of Fargo's operations and employees, as well as the operations and employees of its five subsidiaries, are located in Argentina. Fargo has both secured and unsecured debt, including senior secured debt of approximately \$32 million held by an entity called Bismarck Acquisition, LLC ("Bismarck"), and unsecured notes in the face amount of \$120 million. The unsecured notes were issued under United States law pursuant to a 1998 indenture under which Citibank, N.A. serves as the indenture trustee.

In early 2002, Argentina de-linked its currency, the peso, from the dollar-to-peso exchange rate. As a result, the value of the peso declined dramatically, plunging the Argentine economy into a recession. The poor economic conditions in Argentina led to Fargo's default on a \$7.95 million interest payment due the holders of its unsecured notes in February 2002. On June 28, 2002, in light of its precarious financial condition, Fargo filed a petition seeking relief under Argentine insolvency law in the form of a *concurso preventivo* (the "Concurso"). Similar to the effect a bankruptcy filing under Chapter 11 has in the United States, the commencement of the Concurso triggered an automatic stay under Argentine insolvency law which prohibited actions against Fargo and its assets by unsecured creditors. However, unlike in bankruptcy cases under United States law, secured creditors holding a legitimate pledge of Fargo's assets were exempt from the stay. Bismarck (through Deutsche Bank, its predecessor and assignor) filed a secured proof of claim against Fargo which was deemed valid by the Argentine court. Under Argentine law, Bismarck was thereafter entitled to foreclose on Fargo's assets. In addition, the indenture trustee filed proofs of claim against Fargo on behalf of unsecured creditors in the aggregate amount of \$135 million, representing the full amount of the unsecured notes as well as all unpaid prepetition interest.

INSOLVENCY LITIGATION IN ARGENTINA

Fargo objected to the claims filed by the indenture trustee and, as part of its objection, commenced a proceeding in the Argentine bankruptcy court seeking (1) to have Argentine law, rather than United States law, applied to issues related to the unsecured notes; (2) to have liabilities under the unsecured notes converted from dollars into pesos; and (3) to limit, for voting and distribution purposes, the amounts owing on account of the unsecured notes to the amounts paid for the notes in the secondary market, rather than the principal amount of the notes. The Argentine bankruptcy court rejected Fargo's request for relief and ruled in favor of the indenture trustee on all three issues. Fargo then requested that the Argentine bankruptcy court reconsider its ruling, but the court refused to do so.

Fargo subsequently appealed the Argentine bankruptcy court's decision. Fargo's Concurso was stayed during the pendency of the appeal. In 2005, the Argentine appellate court reversed a portion of the bankruptcy court's ruling and held that, for voting purposes, the indenture trustee's claim should be limited to the amount of unpaid prepetition interest owing on the unsecured notes. The appellate ruling, which had the effect of significantly reducing the amount of the indenture trustee's claims for voting purposes, raised concerns with the indenture trustee because the question of whether such a reduction was warranted under Argentine insolvency law was not before the appellate court. The indenture trustee filed a motion with the appellate court seeking a clarification of its ruling, but its motion was denied. The indenture trustee then filed a motion for leave to file "extraordinary appeals" (appeals filed against final judgments rendered by appellate, provincial, or national courts) before the Argentine National Supreme Court, as well as a motion for a general appeal before that court.

THE INVOLUNTARY PROCEEDING IN THE UNITED STATES

While the extraordinary appeal was pending, on September 11, 2006, a group of unsecured noteholders comprised of Argo Capital Investors Fund SPC, Rainbow Global High Yield Fund, Rainmac Fund, and the Star Fund (collectively, the "Petitioners"), apparently dissatisfied with the

pace and outcome of the litigation concerning the unsecured notes in Argentina, commenced an involuntary Chapter 11 proceeding in the U.S. Court. Collectively, the Petitioners held approximately 65 percent of Fargo's public debt.

Following the commencement of the involuntary proceeding in the United States, Fargo began taking actions in Argentina to reinstate its Concurso, which at the time was still stayed pending the appeals to the Argentine National Supreme Court. On March 6, 2007, Fargo filed a waiver motion with the Argentine appellate court which sought the reinstatement of its Concurso, and stated that, notwithstanding the appellate court's ruling limiting the amount of the indenture trustee's claim to unpaid prepetition interest for voting purposes, Fargo would allow the indenture trustee to vote the full amount of its claim. The indenture trustee requested a ruling from the Argentine bankruptcy court on the waiver motion in order to confirm that the waiver was in fact enforceable.

The National Supreme Court then remanded all issues raised by Fargo's waiver motion to the Argentine bankruptcy court which, on September 11, 2007, one year after the commencement of the involuntary proceeding in the United States, reinstated Fargo's Concurso. As of the U.S. Court's decision on October 12, 2007, the Argentine bankruptcy court had yet to rule on the waiver motion.

THE U.S. COURT'S DECISION: ABSTENTION AND COMITY

The principal ground upon which Fargo sought dismissal of the involuntary proceeding, and the ground upon which the U.S. Court ruled, was Section 305(a)(1) of the United States Bankruptcy Code.² Section 305(a)(1) provides that a court may suspend or dismiss a bankruptcy proceeding at any time if "the interests of creditors and the debtor would be better served by such dismissal or suspension." The decision whether to abstain is committed to the court's discretion and is informed by several factors, including:

- (1) whether another forum is available to protect the interests of both parties or there is already a pending proceeding in state court;

- (2) whether economy and efficiency of administration favor abstention;
- (3) whether federal proceedings are necessary to reach a just and equitable solution;
- (4) whether there is an alternative means of achieving an equitable distribution of assets;
- (5) whether the debtor and creditors are able to work out a less expensive out-of-court arrangement which better serves all interests in the case;
- (6) whether a non-federal insolvency proceeding has proceeded so far that it would be costly and time-consuming to start afresh with the federal bankruptcy process; and
- (7) whether the purpose for which bankruptcy jurisdiction has been sought favors abstention.

In addition to weighing these abstention factors, the U.S. Court also had to weigh considerations of comity (the appropriate respect for and deference to a foreign court), in light of the pending proceedings in Argentina. The U.S. Court noted that the most important comity consideration was whether the U.S. Court could satisfy itself that the foreign forum would determine and adjust the parties' rights in a fair and equitable manner. Once satisfied, the U.S. Court then needed to weigh the relative benefits and burdens of exercising its jurisdiction, and the Petitioners' reasons for commencing the involuntary proceeding.

In considering whether the foreign forum would adjust the parties' rights in a fair and equitable manner, the U.S. Court compared Argentina's insolvency law to that of the United States, and explored Argentina's judicial system generally. With respect to insolvency law, the U.S. Court noted that a *concurso preventivo* bears many similarities to a Chapter 11 proceeding. For example, a debtor operating under the protection of a *concurso preventivo* remains in possession subject to the supervision of a court-appointed trustee and the oversight of a creditors committee. Also, importantly, a company that has filed a petition for a *concurso preventivo* is protected by an automatic stay that prevents unsecured creditors from taking actions against the debtor and its assets, and also prohibits the debtor from paying unsecured prepetition debts. While there are differences between

Argentine and United States insolvency laws (for example, the Argentine automatic stay does not prevent actions taken by a debtor's secured creditors), the U.S. Court found that the Petitioners failed to show that those differences were likely to result in unfair treatment to the Petitioners.

The Petitioners also made a general assertion that Argentina's judicial system is corrupt. In support of this assertion, the Petitioners pointed to the Argentine appellate court's ruling limiting the claim of the indenture trustee for voting purposes. The Petitioners claimed that the appellate court had made both procedural and substantive mistakes, and sought an inference of judicial corruption on this basis. While conceding that the Argentine appellate court had in all likelihood made an error (a proposition with which even Fargo seemed to agree), the U.S. Court nonetheless determined that procedural safeguards existed by which the error could be addressed (i.e., the appeals to Argentina's National Supreme Court), and that, in any event, the error did not impugn the entire Argentine judicial system. The Petitioners also submitted two U.S. State Department reports concerning Argentina to support their charge that the Argentine judicial system is corrupt. The U.S. Court found one of these reports inadmissible and the other one unpersuasive. Accordingly, the U.S. Court determined that the parties' rights could be adjusted in a fair and equitable manner in Argentina.

The U.S. Court next considered the benefits of a Chapter 11 proceeding running parallel to the Concurso. The key considerations for this analysis are the physical locations of the parties-in-interest, the existence of parallel actions, and the nature of the dispute. The U.S. Court essentially combined the first two considerations and observed that a reorganization by *concurso preventivo* in Argentina made practical sense in light of the fact that Fargo's business operations, customers, and employees are all located in Argentina, while Fargo's assets in the United States consist solely of a trademark and three pending trademark applications. Significantly, the U.S. Court observed that the Petitioners had not explained what a confirmed Chapter 11 plan would accomplish. Although the Petitioners had argued that a confirmed Chapter 11 plan could be taken to Argentina and given effect there, the U.S. Court rejected this argument. The U.S. Court reasoned that, even if a Chapter 11 plan were confirmed

in the United States, such a plan would likely not be granted comity by Argentine courts. Indeed, by commencing the involuntary proceeding in the United States, the Petitioners had violated Argentine law (i.e., the automatic stay under the Concurso). Thus, the U.S. Court concluded that any orders issued out of the United States involuntary proceeding would have no impact on the assets being administered in the Concurso.

Finally, the U.S. Court considered the purpose of the involuntary filing. Ultimately, the less-than-noble motives of the Petitioners undermined their credibility and played a significant role in the U.S. Court's decision to abstain. The U.S. Court observed that the Petitioners had bought into the Concurso despite their allegations about the problems with that proceeding. In fact, three of the Petitioners purchased substantial amounts of unsecured notes *after* the Argentine appellate court's problematic ruling limiting the claim of the indenture trustee for voting purposes. In response to the Petitioners' allegations that the Concurso had been effectively hijacked by a group of secured creditors, the U.S. Court noted that it was equally plausible that the Petitioners themselves were seeking to hijack the Concurso, or to gain leverage in a negotiation. Accordingly, the U.S. Court dismissed the Chapter 11 petition.

ANALYSIS

This case is a reminder that United States courts will not lightly deny comity to foreign insolvency proceedings, even if those foreign proceedings do not afford creditors the exact same rights and remedies that they possess under United States bankruptcy law. The U.S. Court's decision held the Petitioners to a high standard of proof with respect to their allegations that they were being treated unfairly by a corrupt Argentine judicial system. The decision suggests that United States bankruptcy courts will not tolerate forum-shopping by creditors if those creditors' rights are not being significantly abrogated — especially if those creditors cannot explain why a United States bankruptcy proceeding would provide a result that cannot be obtained in a foreign insolvency proceeding. In this regard, a debtor's lack of meaningful assets in the United States which could be affected by a United States restructuring will be important.

Finally, creditors who, like the Petitioners, may seek to forum-shop for a jurisdiction that they believe affords them the greatest chance of a substantial recovery should consider their own course of conduct carefully before proceeding. While the Petitioners sought to portray themselves as victims of an inefficient and unfair legal process, the U.S. Court found that they had willingly chosen to participate in a legal proceeding that, although it differed from a comparable United States proceeding, would fairly adjudicate their claims. Not only had the Petitioners purchased claims in the Argentine proceeding, they had done so *after* a court ruled against the interests they then bought. That the Petitioners were unable to explain what a United States restructuring would accomplish that an Argentine restructuring could not further lent credence to the U.S. Court's conclusion that the Petitioners were more interested in gaining leverage in a negotiation, rather than in protecting their rights as creditors.

CONCLUSION

The *Fargo* decision serves as a reminder that United States creditors conducting business that relates to a foreign company should be prepared to become subject to the laws and proceedings of the relevant foreign jurisdiction in the event of a bankruptcy filing. Should United States creditors find themselves involved in a foreign insolvency proceeding, they must be mindful that their recourse to the United States bankruptcy system, if any, may be limited by (i) a high standard of proof for demonstrating the unfairness or corruptness of the foreign judicial system, (ii) a debtor's lack of meaningful assets in the United States and the attendant need for creditors to explain what a United States restructuring would accomplish, and (iii) the importance of the timing of a creditor's investment in a foreign company and the creditor's course of conduct after making such an investment.

NOTES

¹ *In re Compania de Alimentos Fargo, S.A.*, 376 B.R. 427 (Bankr. S.D.N.Y. 2007).

² 11 U.S.C. §§ 101, *et seq.*