

TGS restructuring

TGS models for Argentina

The transaction comprised all of TGS' financial indebtedness and consisted of an exchange of old notes and commercial bank debt for new notes and the amendment and restatement of two Inter-American Development Bank credit facilities. In addition, TGS solicited consents from bondholders and commercial and multilateral lenders to execute and file a restructuring agreement with an Argentine court, pursuant to a newly adopted prepackaged bankruptcy proceeding known as 'Acuerdo Preventivo Extrajudicial', or APE.

The APE is a privately-negotiated debt restructuring agreement supported by consents from holders of a majority in number and two-thirds in total outstanding amount of the affected unsecured debt obligations that, upon court approval, becomes binding on all creditors affected thereby. In addition, upon filing of the APE together with a disclosure statement and the consents from the requisite majorities, all existing and future actions against the company are stayed. Once the APE is filed with an Argentine court, dissenting creditors can challenge the APE on very limited grounds and the intervening court can only review certain aspects of the APE. During the last three years, Argentine companies have used APEs as the preferred way of implementing their restructurings.

TGS transports 60% of the gas consumed in Argentina and, through a pipeline system that is 4,610 miles long under a 35-year concession granted in 1993, is a direct provider to distributors, power stations and industry. TGS is also Argentina's largest processor of natural gas and one of Argentina's largest marketers of natural gas liquids. TGS is indirectly controlled by Petrobras Energía and certain Enron affiliates. Together they hold 70% of its shares. The

Transportador de Gas del Sur (TGS), the operator of the largest pipeline system in Argentina and in Latin America, has successfully undertaken a consensual restructuring of US\$1.02bn in existing notes, commercial bank and multilateral debt. By **Rohit Chaudhry and Carlos T Albarracín, Chadbourne & Parke LLP.**

remaining 30% of the company's stock is publicly traded in both Argentina, on the Buenos Aires Stock Exchange, and the United States, on the New York Stock Exchange in the form of American depository shares.

As a company operating in the Argentine utility sector, TGS was adversely affected by the various emergency measures implemented by the Argentine government following the sovereign's 2002 default, which included the elimination of the fixed exchange rate of Peso 1 to US\$1, the devaluation of the Peso, the pesification of tariffs and the elimination of price and/or tariff adjustments based on foreign currency indexation. These adverse economic measures, coupled with the maturity in 2002 and 2003 of three tranches of bonds totaling US\$400m, significantly impaired TGS' ability to continue servicing its US\$1.02bn in debt and forced it into default.

The purpose of TGS' restructuring was to reduce its existing debt levels and correct the mismatch between cash flows and debt service payments caused by the economic measures described above. In addition, TGS intended to distribute to its creditors cash it had accumulated since it stopped servicing its debt in early 2003. To achieve this, TGS' proposal contemplated an upfront payment to TGS' creditors of a portion of the outstanding principal and past-due interest, an extension of maturities, a reduction in interest rates and the gradual repayment of principal through scheduled amortization and cash sweep payments. Chart 1 provides a description of TGS' debt profile prior to the restructuring, Chart 2 describes the new restructured debt.

The restructuring proposal

During the past two years, APE filings have progressed at a slow pace and have become increasingly litigious. As a result, Argentine companies and their creditors have begun viewing APEs as a relatively undesirable restructuring vehicle.

TGS restructuring

With the objective of avoiding the complexities and time delays associated with APEs, TGS presented a restructuring proposal that included three parallel restructuring options, each of which required a different level of creditor support and offered different incentive schemes. This multifaceted structure, which was intended to align the incentives of TGS and its creditors, allowed TGS to boost the level of creditor consent and implement a restructuring transaction in a short period of time. Under TGS' restructuring proposal, if a 96% consent level was obtained, the restructuring was to be consummated through an exchange offer without an APE, and all cash payments and new instruments would be delivered upon settlement of the offer.

Below that 96% threshold, if consents reached at least 85%, then the restructuring was to be implemented by means of both an APE and a voluntary debt exchange. Under this option, TGS would file an APE with an Argentine court but, instead of waiting for the APE to be endorsed, TGS would issue new debt instruments and make certain payments to consenting creditors pursuant to an exchange offer consummated while the APE was pending. The holdout and non-participating creditors would receive their new notes and remaining consideration upon a cramdown when the APE was endorsed by the Argentine court.

The third option provided that below the 85% consent threshold, TGS would file the APE and wait until it was endorsed by the court to pay the early redemption amounts and past-due interest, and issue the new debt instruments. In the case of the APE restructuring options, TGS reserved the right, following satisfaction of the conditions for any such restructuring alternative, to not file or withdraw the APE, as the case may be, in the event that the consent level continued to increase and, as a result, the conditions of one of the other options requiring a higher consent level were satisfied. (Chart 3 provides a synopsis of the three parallel restructuring options.)

However, since the level of consents obtained by TGS exceeded the 96% threshold (the consent level obtained was 99.76%, which is the highest among recent Argentine restructurings), the restructuring was implemented by means of a voluntary debt exchange and a consensual amendment and restatement of the IDB credit facilities, but without the filing of an APE.

Financial terms of TGS' new debt

Under the terms of the new debt obligations issued by TGS under the implemented restructuring proposal, creditors received: (a) an upfront cash payment in exchange for 11% of the principal amount of their existing debt obligations (at par), (b) in satisfaction of all past-due interest claims, the sum of accrued and unpaid interest at the contractual rates through December 31, 2003 and interest at a rate of 6.18% (weighted average interest rate of the dif-

ferent debt instruments offered in the restructuring) from January 1, 2004 until the date of consummation of the restructuring (December 15, 2004), and (c) two tranches of debt, referred to as Tranche A (in exchange for 52% of their existing debt obligations) and Tranche B (in exchange for 48% of their existing debt obligations).

Tranche A and Tranche B had different scheduled amortizations and final maturities. In the case of Tranche A, the scheduled amortization payments commence on the issue date and end 6 years thereafter, whereas in the case of Tranche B, amortization commences 7 years after the issue date and ends 9 years after the issue date. Tranche B is further divided into two sub-tranches (B-A and B-B). Each of these sub-tranches has a different step-up interest rate and a different calculation for additional interest payments.

In the case of sub-tranche B-A, the additional interest payments, which start on the third anniversary of the issue date, are a function of TGS' revenue generation above certain EBITDA thresholds. In the case of sub-tranche B-B, there is a gradual increase in additional interest (ranging from 0.6% to 0.9%) that takes effect on the third anniversary of the issue date. Both Tranche A and Tranche B are redeemable at the option of TGS. Tranche A redemption may be affected at any time at par plus accrued interest, whereas Tranche B may only be redeemed after Tranche A has been fully redeemed. In addition, sub-tranche B-A can be redeemed upon payment of a redemption premium to compensate for the additional incremental interest-tied to EBITDA generation-that is lost as a result of the redemption.

Furthermore, TGS' restructured debt also contemplates cash sweeps pursuant to which TGS is required to use a portion of excess cash to mandatorily redeem debt. Under this cash sharing scheme, after building certain reserves for investments and contingencies, TGS is required to distribute a portion of excess cash to its creditors (through a mandatory redemption feature under which a portion of excess cash is first applied to redeem Tranche A and then, once Tranche A is fully redeemed, to Tranche B).

In order to align TGS' incentives with the incentives of its creditors, and to provide TGS with cash for government mandated capital expenditures, the creditors agreed that not all of the excess cash would be used for cash sweeps. Rather, only a portion would be applied for cash sweeps, with the remaining being available to be used by TGS for capital expenditures. The portion of excess cash used for cash sweeps depends on the leverage ratio. As TGS' leverage declines, the portion of excess cash required to be swept is reduced. Once the leverage ratio is lower than 3 to 1, cash sweeps are no longer required and TGS can keep the entire excess cash for capital expenditures.

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Covenants of TGS' new debt

One of the complexities of TGS' restructuring was that TGS' old debt instruments contained different covenants with different levels of exclusions and carveouts. To balance the interests of the different creditor groups, TGS presented a proposal that contemplated a common set of core covenants applicable to all of the new debt instruments and a different set of covenants for each of the new debt instruments that largely resembled the existing covenants in the old instruments (except for those superseded by the core covenants common to all the new instruments).

This added complexity to the transaction because Argentine bankruptcy rules governing reorganization proceedings provide for the classification of claims into different groups when a company restructures debts with different characteristics (ie debts with different maturities or denominated in different currencies). This classification of claims allows a company to offer different proposals without violating Argentine bankruptcy rules requiring equal treatment of similarly situated creditors.

Such requirements posed the risk that if TGS offered similar treatment to all of its creditors across classes, non-consenting creditors within those groups who had claims with more advantageous terms prior to the restructuring (ie higher interest rate, stricter covenants) could challenge the restructuring proposal in the APE proceedings on the ground that the proposal was discriminatory against them. One possible way to mitigate this risk would have been for TGS to offer different proposals to the different classes, but that, in turn, required the counting of requisite majorities within each group, which would have increased the risk of failure by TGS to obtain the requisite majorities in all creditor groups.

The new common terms include, among others, restrictive covenants relating to the incurrence of additional indebtedness, grant of liens, incurrence of additional capital expenditures and making of payments and other dividend distributions to TGS' shareholders. These covenants had to be tailored to the particular needs of TGS' reformulated business plan and the evolving regulatory framework in the Argentine utility and energy sectors.

One issue that raised concern among TGS and its creditors was the ongoing concession renegotiation process. Throughout the past three years, TGS has been attempting to renegotiate the terms of its concession with the Argentine government. From TGS' perspective, the main goal is to receive a meaningful tariff increase and some mechanism that would allow the company to adjust the tariff in response to significant economic changes. However, the Argentine government's proposals to date have not met TGS' expectations.

To allow TGS sufficient flexibility to complete the concession renegotiation process after implementation of the restructuring, the new covenant package per-

mits certain modifications to the license which do not (i) shorten the term of the license to less than nine years after the final maturity date of the new debt obligations, (ii) transfer the termination compensation payment to which TGS is entitled in case of early termination under its concession or (iii) adversely affect TGS' ability to perform its obligations with respect to the new debt.

Another issue that had to be considered by TGS' new covenant package was related to the Argentine government's initiatives to mitigate the adverse effects of the energy crisis. Such crisis resulted from an energy shortage caused by the sharp increase in natural gas demand (due to the significant recovery in industrial activity), the pesification of tariffs (which made natural gas a relatively inexpensive fuel as compared to other sources of energy) and the lower hydroelectric generation due to the decrease of rainfall. In response to this energy crisis, the Argentine government required TGS to make additional investments to increase its transportation and compression capacity.

These investments relate, among others, to the expansion of the San Martin pipeline, which transports gas pumped in Argentina's austral basin, one of South America's largest gas reserves. To add to the complexity of this process, the exact amount of these new investments was not known when the terms of TGS' restructuring were being negotiated. According to a recent Argentine newspaper article, the total investment for the proposed pipeline expansion project is US\$285m, of which TGS would be required to contribute approximately US\$40m.

To address this concern, the covenant package of TGS' restructured debt allows the company flexibility to incur, up to certain limits, additional capital expenditures mandated by the Argentine government.

Other features of the new debt obligations addressed specific concerns of the creditors and were designed to align TGS' incentives with the incentives of its creditors. In addition to the cash surplus sharing mechanism described above, the new covenants permit TGS to use alternative funding sources, which include subordinated debt and customer advances to fund certain future capital expenditures. TGS is also permitted to incur additional indebtedness on a limited recourse basis to finance the construction or expansion of assets owned by special purpose entities formed to undertake specific development projects.

The new covenants also allow the creation of certain liens on TGS' assets, including to secure limited-recourse indebtedness incurred by project finance subsidiaries through liens on the shares or assets of such subsidiaries. In addition, to address the concern that the Argentine government could mandate the use of trust funds or other similar structures in connection with pipeline expansion projects, under the new covenant package TGS may grant liens on the new assets developed or constructed pursuant to any directive or mandate of a government regulator.

TGS restructuring

Cramdown of certain creditors

In the context of the APE restructuring alternatives, certain of TGS' debt facilities posed additional complications. The US\$326m IDB loans and a US\$200m of TGS' 144A/Reg S notes insured by Overseas Private Investment Corporation (Opic) were structured in a manner that prevented TGS from imposing the terms of its restructuring proposal on the holders of indirect beneficial interests in such debt facilities through the cram-down effect of the APE procedure. Under Argentine bankruptcy rules, a debtor that files an APE is able to change the terms its debt instruments with the consent of the requisite majorities. If a debtor obtains such majorities, the terms of all of the debt instruments can be amended irrespective of any contractual restriction or requirement that states that certain amendments may only be effected if approved by all the holders of such debt or any supermajority thereof.

In the case of the IDB facilities, structured pursuant to IDB's A/B loan program, certain commercial banks and other investors held participations in the B loan under such facility pursuant to a participation agreement among IDB and such banks and investors. IDB, in turn, is the lender of record to TGS under the related IDB loan agreement, but no legal relationship exists between the participants and TGS.

While this structure is designed to offer certain tax and other benefits inherent to IDB's special status as a multilateral organization, in the context of an APE restructuring, the B loan participation structure poses additional complications due to the fact that the APE procedures are not applicable to the participants because such participants are not direct creditors of the company. As a result of this issue, in the case of the IDB facility, IDB had to solicit and obtain consents from all of the IDB participants before approving the restructuring proposal and amending and restating the related loan documentation to incorporate the restructuring terms. In the case of the TGS

**TABLE 1 –
TGS' DEBT PROFILE - PRE RESTRUCTURING**

Type of instrument	Outstanding principal amount (US\$000s)	Maturities
Pre-export financing loans	25,256	2003
Other short term loans	48,500	2003
Import financing loans	18,856	2003*
Series 1 notes	150,000	2003
Series 2 notes	150,000	2003
Series 3 notes	100,000	2003
TGS notes (OPIC)	200,000	2006
IDB facility loans	326,000	2011
Total debt**	1,018,612	

* Only US\$13m of the total US\$18.856m matured in 2003

** The amounts are as of June 30, 2004 and in thousands of US\$

**TABLE 2 –
TGS' DEBT PROFILE - POST RESTRUCTURING**

Type of instrument	Outstanding principal amount (US\$000s)	Maturities
Tranche A notes	428,090	2010
Tranche B notes	253,222.8	2013
IDB loan - Tranche A	34,710	2010
IDB loan - Tranche B	173,977.2	2013
Total	890,000	

US\$200m 144A/Reg S note, the structure posed additional complications because the holder of such note was a trust governed by Argentine law which, in turn, had issued privately placed notes in the same principal amount and with the same maturities and other terms, which benefited from an OPIC insurance coverage against certain political risks events related to currency convertibility and transferability.

The trust notes were issued under an indenture governed by New York law which required that the consent of each holder be obtained prior to any amendments to the underlying TGS-issued note, which the trust held as its own asset. Therefore, like in the case of the IDB participants, the trust could not consent to the TGS restructuring without, in turn, obtaining consents from 100% of the holders of the trust notes.

However, since the trust notes were in default, under the terms of such indenture the holders of the trust notes could force the trust to dissolve and distribute the underlying TGS note to them in order that they can participate in the restructuring. Unlike the amendments to the terms of the notes or the underlying TGS note which required consents from all the holders of the trust notes, this action could be implemented by holders of 51% of the trust notes. Using this procedure, the Argentine trust holding the TGS note was unwound and the underlying 144A/Reg S notes were distributed out to the holders of the trust notes, which, in turn, tendered such notes as part of TGS' restructuring.

**TABLE 3 –
SYNOPSIS OF RESTRUCTURING OPTIONS**

Consent level	Restructuring option
More than 96%	Exchange Offer
Between 85% and 96%	In-APE Exchange
Between Requisite majorities (51% in number of creditors and two-thirds in principal amount of claims) and 85%	Cramdown pursuant to the APE Exchange

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