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Weekly Report for International Finance Executives

The EU and IAS 39

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Amendment of the accounting standard relating to financial instruments has created uncertainties about how to apply the International Financial Reporting Standards that became effective for most EU companies as of January 1st.

Pauline Ashall, Lucy Fergusson and Anthony Fawcett, Linklaters

European Union (EU) issuers subject to the IAS Regulation will have to produce consolidated financial information in accordance with International Financial Reporting Standards (IFRS) beginning this year, as endorsed for this purpose by the European Commission.

This article considers the implications within this regime of the recent EU decision to endorse IAS 39, the standard relating to accounting for financial instruments, only in part.

Background

IAS 39 is a standard issued by the predecessor of the *International Accounting Standards Board* (IASB). It is concerned with the treatment of "financial instruments" in accounts.

The standard was originally published as long ago as 1998 (which explains why it is an International Accounting Standard [IAS], rather than an IFRS, which is more up-to-date terminology).

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European Banking Consolidation

Increasing capital and human resources required to provide pan-European and global cash management will inevitably reduce the number of banks that can provide such services directly.

A Discussion with Michael Mueller of Deutsche Bank

Year after year, the number of big banks able to offer their corporate clients a full range of cash management services is becoming smaller and smaller.

In part this stems from a flurry of mergers, which has seen banks gain scale to become global behemoths. It also reflects the rising costs that banks are facing, as a result of:

- keeping up with new standards in security and technology;
- implementing new formats, such as SWIFT XML;
- capacity issues; and
- regulatory initiatives, for example those concerning anti-terror legislation or money laundering.

All these external pressures mean margin pressures for banks, which is what is prompting this review of structures.

"We have a cost and pricing development in this market that

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APE: An Argentine Tale

A non-judicial procedure intended to streamline restructuring of troubled local companies has become mired in its own vague language, litigious opposition by creditors and other interested parties and unexpected intervention from the courts—first of two parts.

Rohit Chaudhry and Carlos Albarracin, Chadbourne & Parke, LLP

APE is a procedure...in which a privately-negotiated debt restructuring, supported by a qualifying majority of creditors, can be imposed on recalcitrant creditors.

Banks and other creditors are developing creative ways of restructuring distressed companies in Argentina. However, their experience with the new restructuring procedure called *acuerdo preventivo extrajudicial* (APE) has not been entirely satisfactory.

APE is a procedure in Argentina, similar to a pre-packaged bankruptcy in the U.S., in which a privately-negotiated debt restructuring, supported by a qualifying majority of a company's creditors, can be imposed on recalcitrant creditors.

The plan is filed with an Argentine court for approval. Once court approval is obtained, the terms of the restructuring are binding on all the company's creditors affected by the APE, whether or not they were part of the qualifying majority that supported the terms of the restructuring.

During the last three years, companies in Argentina have spent significant amounts of time restructuring their businesses and negotiating restructuring plans with their creditors. A large majority of these distressed companies have used APE as the preferred way of implementing restructuring.

However, as APE filings have progressed at

a slow pace and have become increasingly litigious, in recent months companies and their creditors have begun viewing the APE as a less desirable restructuring vehicle than they originally anticipated. This change in perception has forced companies and their creditors to rethink restructuring strategies and to come up with more creative and incentive-oriented approaches.

Background

The Argentine bankruptcy laws were amended in May, 2002, in response to the economic collapse. Among other changes, the 2002 amendments allowed distressed companies and their creditors to use APE, upon endorsement by the court, to bind all the company's creditors affected by the APE, including dissenting and non-participating creditors.

In addition, amendments provide that, upon filing an APE, all claims against the company that are affected by the APE are frozen.

Before the amendments, debt restructurings were accomplished primarily through *concurso preventivo* proceedings, which are similar to Chapter 11 proceedings in the U.S.

The out-of-court restructuring agreements

As APE filings have progressed at a slow pace and have become increasingly litigious, companies and their creditors have begun viewing the APE as less desirable.

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under the APE procedure that existed prior to the 2002 amendments were not popular, because they were not binding on creditors that were not parties to the agreements and did not bar litigation related to the restructured claims. They led in many cases to legal challenges and then to the distressed company filing for *concurso preventivo*.

Under the amended APE procedure, a company that is in default or in general financial distress may enter into an out-of-court restructuring agreement with its creditors, just as before. As a result of the 2002 amendments, upon filing of such an agreement in an Argentine court, all claims against the distressed company that are affected by the APE are frozen. Further, upon court endorsement, the agreement is binding upon all creditors.

In order to implement an APE, the executed restructuring agreement must be filed in an Argentine court for endorsement, together with supporting documentation such as a statement of assets and liabilities, a schedule of creditors and a schedule of outstanding litigation.

Court endorsement of an APE requires consent of holders of a majority in number and two-thirds in total outstanding amount of the affected unsecured debt. Unsecured creditors that are also controlling shareholders of the distressed company are not taken into account when determining the qualifying majorities.

In a *concurso preventivo*, the consents to the restructuring plan typically would have to be obtained by the distressed company at the end of the restructuring process, which commences upon the filing of a petition seeking relief. In contrast, in an APE, consents are generally required up front at the time of filing of the APE.

However, in certain cases, APEs have been filed without obtaining the required creditor consents. This has allowed a company to get the benefit of the freeze on all claims affected by the APE while it sought support from a qualifying majority of its creditors.

A company and its creditors should be free to restructure as they see fit. The APE rules provide for almost no substantive review of the restructuring agreement by the APE court.

Once a petition for court endorsement has been filed, it must be publicly disclosed by publishing notice of the filing for five days in Argentine newspapers and in the official gazette. Creditors then have 10 court days to file objections.

Objections can only be filed on the ground

that the company overstated or understated its assets or liabilities or on the ground that the qualifying majorities have not been obtained.

If objections are filed, then a further court-day period is provided for the production of evidence, after which the court is required to issue its opinion. If no objections are filed, then the judge must endorse the APE simply upon verification that the necessary documentation has been filed and the qualifying majorities obtained.

Thereafter, objecting parties and creditors have a period of six months after endorsement to challenge the endorsing court's decision.

Theory vs. Practice

In theory, the APE rules provide an expedited mechanism for restructurings. However, the reality has been that APE restructurings have become litigious, complex and time-consuming. While it is clear that the time involved in a restructuring implemented by means of an APE are far smaller than the typical two to four years required for *concurso preventivo*, these time periods are far in excess of what was originally contemplated under the statute.

APE rules are, in many important aspects, vague and incomplete. Over the last couple of years, court decisions have shed new light on these provisions. In addition, since the 2002 amendments, numerous Argentine bankruptcy law commentators have theorized about the application and interpretation of the APE rules and their interplay with rules governing *concurso preventivo*. However, ambiguities remain that result in delays and conflicting interpretations.

Duration of the APE process is one problem. The rules provide an expedited timetable for endorsing the APE once it is filed with an Argentine court (five days for publishing notices of an APE filing plus 10 days for the filing of objections and an additional 10 days for addressing any such objections and issuing the endorsement decision). However, this statutory timetable has rarely been followed. In practice, it has taken up to one year from filing an APE to obtaining court endorsement.

Such delays have resulted from factors ranging from delays in declaring commencement of the process and admission of challenges from alleged creditors (who failed to make even the most basic case that they are affected by the APE), to filing of appeals to an APE based on unconstitutionality of the 2002 amendments to the Argentine bankruptcy laws.

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The rules provide an expedited timetable for endorsing the APE once it is filed with an Argentine court; however, this statutory timetable has rarely been followed.

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For instance, in the *Multicanal* APE, the court delayed its decision to endorse the APE for several weeks as a result of a challenge filed by a Paraguayan company that was suing Multicanal in Paraguay in connection with indemnity issues under a stock purchase agreement.

The Paraguayan company argued that Multicanal “had omitted such entity from the schedule of creditors and understated its liabilities.” However, under Argentine accounting principles, it was clear that the lawsuit did not have to be recorded as a liability by Multicanal and, therefore, the claimant appeared to lack standing to oppose the APE.

Delays of up to one year have occurred even in cases where creditor support was as high as 90 percent. In *Sideco Americana*, it took three months for the court to declare the process commenced after the filing date, even though the APE rules provide that the process should commence “upon filing of the APE.”

In addition, the Sideco court delayed its decision on endorsement as a result of objections filed by third parties who neither held loans, bonds or any other claims of Sideco Americana nor proved standing to oppose the APE.

The accompanying table lists cases in which the APE approval process has taken longer than the statutory timetable.

A Quandary for Energy Companies

Such delays raise special concerns for restructuring in the energy and utility sectors in Argentina, above and beyond the concerns one might typically expect a creditor to have in any delayed closing. This is because, in these restructurings, in addition to the distressed company and creditors, the Argentine government is very often the unseen third party at the negotiating table.

Over the last few years, the Argentine government has been looking for ways to overcome the crisis in energy and utility sectors by requiring additional investments by private companies in these sectors.

Such investments have not been voluntarily forthcoming from the players involved. As a result, the Argentine government has been looking to use various coercive measures to compel existing companies in these sectors to make further investments. For example, the government is contemplating creating “financial trusts” for making these investments and ordering private companies to divest a portion

of their future revenues or existing cash to fund these financial trusts.

It is not clear how large a portion of future revenues or existing cash the existing companies might be asked to divest to fund these financial trusts.

Consequences of Delayed Debt Service

This threat is magnified by the fact that in many cases Argentine companies stopped servicing their debts soon after commencement of the economic crisis, in order to increase leverage over their creditors. Consequently, many of them have large amounts of cash on their balance sheets, which are being eyed as much by the Argentine government as by the creditors of the companies.

While the companies generally acknowledge that this cash ought to be used to pay creditors, they are reluctant to make such cash payments prior to APE endorsement in order to maintain their leverage throughout the restructuring process.

Any delay in the APE process increases the risk that this cash may not be available by the time the APE is endorsed if the companies are compelled to use the cash for government-mandated investments.

The Problem of Proactive Courts

The process for court review of restructuring agreements is another problem.

Following introduction of the APE rules, a number of observers noted a novel feature of the new rules was that a distressed company and its creditors could structure the APE agreement in any manner that they deemed fit; court review would be limited to verifying compliance with basic legal requirements (requisite majorities, completeness of accompanying documentation, etc.).

This principle was initially construed as allowing flexibility for a company to negotiate the terms to be offered to its creditors and provide incentives that could increase the level of support or attractiveness of the offer. However, in practice, Argentine courts have not allowed absolute freedom to companies and creditors in structuring APE agreements.

In fact, in most APE cases, Argentine courts have borrowed concepts that govern *concurso preventivo* and have performed thorough substantive reviews of these agreements. Moreover, in some cases courts have gone as far as

Delays of up to one year (in APE processing) have occurred even in cases where creditor support was as high as 90 percent.

In most APE cases, Argentine courts have borrowed concepts that govern *concurso preventivo* and have performed thorough substantive reviews of these agreements.

modifying the terms of the APE agreements filed with the court to equate the treatment of consenters and non-consenters or to remove certain features that the court viewed as contrary to bankruptcy law principles of fairness and equal treatment.

Because of such substantive reviews by courts, distressed companies and creditors are now reluctant to include certain terms in restructuring proposals that might otherwise have made the restructurings more robust.

For instance, it is common in restructuring arrangements to provide for certain “up-front” cash payments only to consenting creditors (but not to holdouts or non-participating creditors) in order to induce creditors to consent to the restructuring. It is not clear whether such payments would pass the fairness and equal treatment tests that Argentine courts apply to APEs.

In some restructurings, debtors use coercive measures such as stripping the covenants that run to the benefit of holdout or non-participating creditors. Again, the idea is to induce creditors to consent to the restructuring in order to receive a more favorable covenant package. It is not clear whether such covenant stripping would be permitted by Argentine courts in an APE.

In the Multicanal APE, holdout and non-

participating creditors were only given a ratable portion of new notes and a combination of new notes and shares (which were two of the three options offered to consenters) in exchange for their restructured claims, but were excluded from the cash payment offered to consenting holders.

To avert the likely risk that the court could find the APE objectionable on the basis of discrimination against non-consenting creditors, the Multicanal APE was amended to provide that non-consenting creditors will receive a prorated portion of each of the three options offered to consenting holders.

Upon confirmation of the APE, the court required as a condition to endorsing the APE that Multicanal provide bondholders who voted against the APE or abstained a thirty-day period to elect the same consideration options given to those who voted in favor of the APE.

In Sideco Americana, in which the APE was filed with the support of 95 percent of the company’s creditors, the court required that the APE be amended as a condition to endorsement to provide that non-consenters receive one of the three options available to consenters (10-year floating rate notes) instead of a residual and less attractive option provided to non-consenters.

In some restructurings, debtors use coercive measures such as stripping the covenants that run to the benefit of holdout or non-participating creditors. It is not clear whether such covenant stripping would be permitted by Argentine courts in an APE.

Company	Launch Date (APE Solicitation/ Offer to Exchange)	APE Filing Date	Endorsement or Closing Date	Restructuring Method Proposed	Restructuring Method Used	Creditor Majority Obtained	Amount Restructured (\$ Mio.)
AUSOL	March, 2003	12/03	April, 2004	APE	APE	95%	337
MULTICANAL	February, 2003	08/03	October, 2004*	APE	APE	68%	525
ACINDAR	March, 2003	12/03	August, 2004*	APE	APE	87%	100
CTI HOLDING	August, 2003	05/04	December, 2003	APE	APE	92.9%	310
SIDECO	November, 2003	12/03	July, 2004	APE	APE	94%	170
TELECOM	June, 2004	10/04	Pending	Parallel APE/ Exchange Offer	APE	94.5%	2,700
BANCO HIPOTECARIO	December, 2003	N/A	(APE rejected October, 2004)	Parallel APE/ Exchange Offer	Exchange Offer	97%	1,205
BANCO DE GALICIA	December, 2003	N/A	May, 2004	Parallel APE/ Exchange Offer	Exchange Offer	98.2%	1,320
PIEDRA DEL AGUILA	February, 2004	N/A	June, 2004	Parallel APE/ Exchange Offer	Exchange Offer	92%	280
TGS	October, 2004	N/A	December, 2004	Parallel APE/ Exchange Offer	Exchange Offer	99.7%	1,026
MASTELLONE	March, 2004	N/A	October, 2004	Parallel APE/ Exchange Offer	Exchange Offer	97.8%	340
			*Appeal Pend'g				

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access to first-class cash management products from a company's relationship bankers.

"It gives them an additional provider. Overall, I think that should be good news for Finance Directors," he concludes

Corporations in the Driver's Seat

For many Finance Directors, the question is: how sophisticated do they want the cash management process to be? Mueller points out that, if availability of state-of-the-art products and services is a priority, questions have to be asked as to whether the bank can provide these.

"This is where some of the consolidation pressures come from," says Mueller.

"Because some of the corporations have realized that their main relationship banks might not be able to provide this kind of structure to support their future aspirations, they are teaming up with a provider that can allow them to do other things."

One further positive consequence of collab-

orative banking should be intensifying the drive to harmonization of European banking structures through such initiatives as the *European Payments Council* (EPC). There will undoubtedly be some major casualties in the European cash management market during the transition, but European businesses can be reasonably positive that some beneficial new services will emerge from the consolidation process. □

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(A) positive consequence of collaborative banking should be intensifying the drive to harmonization of European banking structures through such initiatives as the European Payments Council (EPC).

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The Definition of "Performance"

Another issue that has puzzled Argentine companies and has been the subject of extensive debate is when the APE is deemed "performed."

This is critical for debtors because, until an APE is deemed "performed," the debtor's non-performance of any obligation under the restructuring plan requires that the reviewing court declare the commencement of liquidation proceedings or *quiebra* (similar to Chapter 7 liquidation proceedings under the U.S. bankruptcy code).

Unlike U.S. Chapter 11 reorganization proceedings, an Argentine company only emerges from its *concurso preventivo* when the reviewing court issues a resolution confirming full satisfaction of all restructured claims, which may take several years.

This principle of Argentine bankruptcy law was undisputed until 2003, when a Buenos Aires court, in apparent contradiction of the *concurso* rules, confirmed a restructuring plan that provided, upon delivery of the new notes to the affected creditors, the distressed company will be deemed to have performed its obligations under the restructuring plan, thereby emerging from bankruptcy. On the theory that this also applies to APEs, Argentine companies restructuring debt through an APE included provisions in their restructuring plans

providing that, upon delivery of the new instruments to their creditors, the terms of their APEs will be deemed performed.

However, in the recent *Acindar* APE decision, the court rejected the theory of performance by delivery of the new instruments. Instead, it expressly stated that the principles applicable to *concurso preventivos*, that dictate that the reorganization plan is only performed upon full repayment and performance of the obligations in the plan, also apply in an APE proceeding.

As a result, the risk for Argentine debtors in an APE is that if the company fails to perform any of its obligations under the restructured debt, then the company could be liquidated, without the possibility of any further restructuring.

The concluding installment, which will appear in the next issue of *F&T*, will address such collateral issues as the mechanics for determining a majority of creditors for purposes of an APE and the danger of extraterritorial challenges to APE arrangements. It will also explore innovative alternatives being developed by the private sector to end-run the existing problems with the APE procedure. □

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