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LEGAL MEMORANDA

ARGENTINA

The following is a review of legal and economic developments in Argentina.

I. LEGISLATIVE AND ADMINISTRATIVE RULINGS

A New Privatization Law—Debt-to-Equity Conversion Possible

In today's world, the large state-owned sector of the Argentine economy has clearly become expensive and inefficient. The biggest loser in the economic scheme is the consumer, who deals not only with poor services, but also with high costs, primitive equipment, and corruption. Recognizing this imbalance, the recently elected administration sought to privatize the economy.

Under a privatization program, portions of the industrial sector controlled by the government are transferred to private control and operation. Assuming that privatization efforts are successful, less governmental interference in the economy should translate into a government which merely regulates some of the industries, rather than acting as it now does as a major producer; monitors the performance of private parties in a variety of services presently provided by financially bankrupt public agencies; and receives returns by way of royalties, rents or taxes.

Through privatization and deregulation, Argentina seeks to replace state-owned agencies with equivalent private sector enterprises. Currently, state-owned agencies operate with captive consumers and purchase services and equipment primarily from favored state-owned suppliers. In order to break from this inefficiency, a host of new private companies is expected to assume the challenge of privatizing the Argentine economy.

To achieve privatization, Law 23.696 authorizes the Executive Branch to: 1) replace the board of directors or administrators of companies and agencies presently owned by the federal government with intervenors, appointed by the Executive to assist in the privatization process, who will supervise the reorganization of the respective company or agency to which the intervenor is appointed; 2) transform, when necessary, state-owned enterprises into corporations or other vehicles which allow private participation; and 3) merge, spinoff, transform or reorganize the respective company or agency as necessary.

In order to be privatized, a company or agency must first be formally declared "subject to privatization" under Law No. 23.696. The executive branch must make this declaration with the approval of Congress. This declaration, however, is not required where the state already has a "controlling stock participation." In such cases, the law authorizes the executive branch to sell the stock participation of the company without any further approval or consent.

Law 23.696 also contains an exhibit listing all companies or agencies whose privatization (total or partial) have been *ex ante* decided or authorized. The companies and agencies to be totally or partially privatized include:

- 1) Empresa Nacional de Telecomunicaciones (ENTEL);
- 2) Optar, an Aerolíneas Argentinas captive domestic wholesale travel agency;
- 3) Aerolíneas Argentinas (a partial privatization of this Argentine national airline is sought);
- 4) Buenos Aires Catering, a catering joint-venture between Aerolíneas Argentinas and Swissair;
- 5) Empresa Líneas Marítimas Argentinas (ELMA), the state-owned shipping company;
- 6) Yacimientos Carboníferos Fiscales, a coal producer with a marginal mine (Rio Turbio) located in Patagonia;
- 7) Conarsur, a consulting company;
- 8) Dirección Nacional de Vialidad (it is envisioned that the government will contract out to private companies road repair, maintenance, and some infrastructure construction work);
- 9) Ferrocarriles Argentinos (the government will contract out to private parties all railway cargo services, maintenance, and re-

pair work, as well as some infrastructure development work);

10) Empresa Nacional de Correos y Telégrafos (the Post Office will deregulate this sector and contract out services);

11) Yacimientos Petrolíferos Fiscales (YPF) (the activities of the state-owned oil and gas agency will be privatized by continuing the practice of entering into service and joint-venture agreements with private companies for the exploration and exploitation of oil and gas fields; concessions and secondary or tertiary recovery contracts are also foreseen as a means to privatize YPF's activities);

12) L.S.84 TV Channel 11 and L.S.85 TV Channel 13 (although these television stations will be sold, the State, nevertheless, will keep one television station, L.S.82 TV Channel 7 in which foreign participation will not be allowed);

13) L.R.3 Radio Belgrano and L.R.5 Radio Excelsor (the State will retain ownership and foreign participation will be allowed in LRA.1 Radio Nacional, Radio Difusión al Exterior (RAE), and the national radio network);

14) Subterráneos de Buenos Aires, the Federal District subway agency;

15) Coordinación Ecológica Area Metropolitana Sociedad del Estado, a company jointly owned by the City of Buenos Aires and the Province of Buenos Aires, which is a large urban landowner, in charge of contracting refuse collection services and landfill operations;

16) Casa de Piedra, electricity supply;

17) All of the City of Buenos Aires' recreational, cultural, and maintenance services;

18) Junta Nacional de Granos (the sale of different grain storage facilities is envisioned);

19) Administración Nacional de Puertos (port authorities will either be privatized or transferred to the province where they are geographically located);

20) Casa de la Moneda (the government will contract out to private companies the printing of currency, public bonds, and securities);

21) Talleres Navales Dársena Norte (TANDANOR), a shipyard located in the Port of Buenos Aires; and

22) Compañía Azucarera Las Palmas S.A., a sugar mill.

Agencies to be transferred to provincial or municipal jurisdiction through *ad hoc* agreements are:

- 1) Obras Sanitarias de la Nación, which is responsible for water supply and sewage services;
- 2) Dirección Nacional de Vialidad, which is responsible for road construction and maintenance services; and
- 3) Gas del Estado (the government will transfer to local agencies the distribution of natural gas).

Agencies to be completely reorganized through eventual merger are:

- 1) Water supply and sewage services in and around the City of Buenos Aires, inside and outside of the Federal District;
- 2) Exploration, production, distribution, and supply of oil, gas, and coal; and
- 3) Generation, distribution, and supply of electricity' (the merged agencies will contract out most distribution activities to private parties and priority will be given, where feasible, to cooperatives).

A large across-the-board privatization effort is expected. When privatization is completed, it will change the economic profile of Argentina, where the State has retained a frustrating and dominating stronghold for so long.

In the process of privatizing a company or agency, the executive branch also has the power to deregulate the sector or activity. By eliminating or dismantling privileges, restrictions or monopolies which could frustrate privatization efforts or result in the replacement of a State monopoly with a private monopoly, success of the program could be virtually guaranteed. Undoubtedly, sweeping reforms will be necessary in several sectors.

If the privatization of an agency is not possible, the executive branch is specifically authorized to liquidate the agency. Termination may be the only possible alternative when dealing with companies or agencies which, at present, are economically unfeasible.

Under Law No. 23.696, an individual decree is to govern the privatization process of each company or agency. This individual decree will set and define the procedures, mechanisms, and conditions to which the respective privatization will be subject. Nevertheless, Congress will monitor all privatization efforts through a special Committee composed of six members of the Senate and six

members of the Chamber of Deputies.

Moreover, Law 23.696 allows for different privatization procedures and alternatives, such as sales of assets or stock, transformation, formation or spinoffs of companies, mergers, liquidations, permits, licenses, and concessions for the exploitation of public services. Debt-to-equity conversions are also specifically permitted. As a formal component of the Brady Plan, debt-to-equity conversions are particularly attractive because they have no detrimental expansionary effect on the money supply.

The law also contemplates the possibility of privatizing companies or agencies where the State assumes all or part of the companies' individual indebtedness or liabilities. Without this alternative, the privatization of companies or agencies with a large foreign debt will not be feasible.

The government may give total or partial preferences to parties presently having a partial ownership of the entity being privatized. Still, employers, suppliers, and/or customers can be included in a program (*Programa de Propiedad Participada*) through which they may obtain soft financing.

As a rule, the government will privatize through public calls for bids, public auctions or sales made at the stock exchanges. Nevertheless, on a smaller scale, the government can enter into direct contracts with employees, suppliers or customers. When awarding contracts, the executive branch must take into account the highest offered price or bid, but also any other possible benefits to public or common interests.

Public agencies must always appraise the value of the companies or assets to be sold. However, when the public agencies lack the capacity to do the respective appraisal, international agencies or other foreign or domestic private parties will conduct the appraisals.

Prior to executing any contract under the privatization procedures, the *Tribunal de Cuentas de la Nación* and/or the *Sindicatura General de Empresas Públicas* must give its opinion. These control and supervision agencies must either object to the execution of the contract or suggest changes to the contract within ten days after being contacted. Otherwise, the transaction may go forward as negotiated.

Law 23.696 also contains provisions which regulate the current "administrative emergency" in Argentina. During such an emer-

gency, the government must follow special contractual procedures defined in this law. Law 23.696 established special *ad hoc* contractual termination mechanisms and rules governing a suspension of enforcement of all judgments against the State. Using these rules, the administration seeks to reorganize its chaotic situation while simultaneously allowing the privatization drive to progress and thereby slowly erode the main cause of the State's economic problems and failures, namely, its overwhelming role of inefficient provider of everything. The challenge is difficult considering the role of the State as employer, employing one out of every four Argentine workers.

Following the enactment of Law 23.969, the Executive Branch issued the first decree laying down individual rules for the privatization of Empresa Nacional de Telecomunicaciones (ENTEL). ENTEL, like most Argentine state-owned service companies, is malfunctioning. It is an inefficient and corrupt communications monopoly.

The government was to offer the whole Argentine territory, divided in three regions to private companies, both foreign and local, through a call for bids. The government entrusted the Ministry of Public Works with the duty of preparing the first draft of the corresponding bidding conditions. The executive branch was to review bids. In turn, the executive branch was to determine whether ENTEL will be released from its present indebtedness in order to make privatization opportunities more attractive. Further, the executive branch was to grant its final approval to the bidding conditions by December 31, 1989. Due to the complexities involved, however, the government railway agency, Ferrocarriles Argentinos, has replaced ENTEL as the lead candidate for privatization. The Federal Government expects to award the respective licenses to private parties prior to June 28, 1990. Licensees will have to organize themselves as *ad hoc* corporations. In each case, the operator is to hold not less than fifty-one percent of its capital and votes. The decree further foresees a participation by the licensees' employees of up to ten percent.

In exchange for minimum service and technological commitments, licensees will operate for an initial five-year term, during which they will enjoy substantial exclusivity in their respective areas. This exclusivity, however, will cover only basic services. For example, data processing, information, and mobile telecommunications will be open to third party competition right from the begin-

ning of the license. After this initial period, the government will fully deregulate the areas and open the areas to competition from service providers.

Should the privatization process maintain reasonable strength and momentum, it will be able to overcome expected trade union resistance and contribute to a gradual reduction in the public sector deficit. This reduction of the deficit is a signal required to avoid pessimism which continues to erode Argentina's confidence in its economy. Although the process is risky and strenuous, it remains a time for change and opportunity.

U.S. Investments Insurance Guaranty Program Expanded

Over the years, the United States government has insured, under the Investment Guaranty Program (the "Program"), funds invested abroad by American citizens or corporations. Since 1971 when it began its operations, the Overseas Private Investment Corporation (OPIC), has managed the Program. The Program began in 1948 in response to the role private investors played in the reconstruction of Europe under the Marshall Plan. In the 1950s, its focus switched toward the developing world.

The insurance scheme requires the negotiation of a bilateral treaty with each individual host country where insurance is to be provided, thus spelling out on a case by case basis procedures to be followed. In this manner, the United States government reduces its own risk by obtaining, in advance, clear procedures to be followed in the event that a claim should be honored. Through the Program, U.S. investors can obtain coverage against varying political risks, such as convertibility, expropriation, war, revolution, and insurrection. OPIC also provides financing through direct loans or guarantees under certain conditions to investments that could be made in cash, technology or equipment.

On December 22, 1959, Argentina and the United States entered into a bilateral treaty. As required by Argentine law, the Argentine Congress subsequently ratified the treaty through Law 15.803 enacted on May 5, 1961. The law only provided for the so-called convertibility guarantee. Under the convertibility guarantee, if an investor was prevented from transferring profits, earnings or capital into U.S. dollars for a certain period of time, the investor could obtain the corresponding dollar payment from the United States Government. Inconvertibility coverage also protects inves-

tors against the possibility of adverse discriminatory exchange rates. This coverage does not, however, protect against devaluation of the host country's currency. In return for this guarantee, the Argentine Government agreed to transfer the respective dollars, when available, to the United States Government and acknowledge the subrogation by the United States Government of all rights the investor may have had. The Argentine Government later extended coverage to include expropriation risks, and the risk of war, revolution, insurrection, and civil strife. On June 5, 1963, the Argentine Government executed a special protocol (*Protocolo Adicional*) for such a purpose.

The treaty remained operative until 1971 when the treaty became inactive due to the then prevailing local political conditions. With the gradual changes introduced by the present Argentine Government aimed at economic development, the treaty was reactivated in 1986. Since the reactivation, OPIC has granted financing to five Argentine projects. An additional ten projects are under consideration. OPIC also has an "Opportunity Bank" in Washington, D.C., which provides information linking potential U.S. investors with entrepreneurs that help set up new projects in developing countries.

The Argentine Government recently expanded the Program through Decree 618/89, dated May 23, 1989. The Decree provides, among other things:

- 1) The Argentine Government must grant approvals by the method established by the Decree. Under the bilateral treaty, only those projects expressly approved by the Argentine Government are provided coverage;

- 2) The Ministry of Economy issues approvals requested in connection with projects falling under the scope of the Foreign Investment Law. If foreign investments do not require an *ex ante* approval by the Foreign Investment authority (Law 21.382, Articles 4 and 6), the Ministry must issue the guaranty approval not later than thirty days from the filing of the corresponding request; and

- 3) The Argentine Government may now issue approvals to projects having an Argentine risk, but which, nevertheless, do not contain an investment component. In these particular cases, requests must be filed with the Legal and Technical Secretary of the Presidency of the Republic. The Secretary, after reviewing the re-

quest, must recommend either its approval or its rejection. Approvals, when granted, require the National Executive Power to issue a decree. Such approvals must be registered in a special Registry created by Decree 618/89.

It is to be hoped the new regulation will simplify proceedings and foster U.S. investments in Argentina. The amount of U.S. investments recorded in 1988 reflects increased desire to invest by investors who have taken advantage of OPIC insurance: US\$536 million in twelve projects, ranging in size from US\$250,000 for a smaller commercial operation to US\$245 million for a large petrochemical venture by Dow Chemical. There are currently twenty projects under consideration, representing an investment of the United States of approximately US\$400 million.

Also under the Decree, the Argentine Government may now review a wide variety of new forms of international agreements. If the agreements are approved, the government may include the agreements in the traditional investment insurance program. These agreements include: license agreements, leasing, franchising, management contracts, turn-key projects, production-sharing arrangements, and service contracts.

II. JUDICIAL DECISIONS

Judicial Collection of a Check Drawn on a Foreign Bank— Notice of Dishonor

In *Rhodia Argentina S.A. v. Polisecki*, an Argentine corporation sued an Argentine resident in an Argentine Commercial Court to collect on a check drawn by the defendant on a New York bank.

The New York bank refused to pay the check upon presentation because there were no funds available in defendant's account. The bank stated, in writing on the instrument, that payment had been refused for lack of funds. Although under New York law, the bank's actions would serve as full proof of dishonor, without the requisite of formal protest, the issue was whether the writing constituted a formal protest under Argentine law.

In proceedings below, the trial judge refused to enforce plaintiff's claim on the ground that the plaintiff did not make a formal protest of the check, a procedural enforcement prerequisite under Argentine law.

The National Commercial Court of Appeals reversed the lower

court and allowed the plaintiff's right to enforce the check. Thus, the Court held that enforcement of a check must take into account the laws of the domicile of the bank against which it is drawn. The Court found in this case that the laws of the State of New York governed the notice of dishonor. The Court further maintained that the Argentine Court could apply foreign law *ex officio*, even when the parties have not requested or proved its applicability. As a result, the Court applied Sections 3-301, 3-508(5), and 3-510(8) of the Uniform Commercial Code, as applicable in the State of New York, to this case and recognized the New York bank's writings as full proof of dishonor.

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