Linklaters

June 2012

In re Vitro: The Limits of Comity Under Chapter 15

On June 13, 2012, the United States Bankruptcy Court for the Northern District of Texas in the Chapter 15 case of Vitro, S.A.B. de C.V.[1] ("**Vitro**") refused to enforce an order entered by a Mexican court approving a reorganization plan under Mexican law. The Bankruptcy Court held that the Mexican plan was "manifestly contrary" to US public policy to the extent that it sought to extinguish the guarantee claims of certain noteholders against US non-debtor subsidiaries. The Bankruptcy Court weighed the principles of comity, which suggests deference to the orders of courts entered in other countries, against its concerns that the Mexican court's approval order violated a fundamental public policy contained in the Bankruptcy Code. The Bankruptcy Court concluded that enforcement of the releases of the US non-debtor subsidiaries as contemplated by the Mexican court approval order would potentially permit foreign debtors to go down the proverbial slippery slope in proposing restructuring plans that permit broad, non-consensual releases to the disadvantage of creditors "without any seeming bounds."[2] As a result of the Bankruptcy Court's decision, the noteholders are permitted to pursue remedies against the non-debtor subsidiaries that guaranteed their debt.[3]

This decision is important to the lending community because, particularly if upheld on appeal and followed in other US jurisdictions, it is less likely that non-US borrowers will be able to use their home forums to restructure debt of US subsidiaries on a non-consensual basis. As we see more non-US borrowers trying to access the US markets to raise capital as a result of economic uncertainty in different regions of the world, this could become an important issue in many future restructuring negotiations.

Contents

1 *See Vitro, S.A.B. de C.V. v. ACP Master, Ltd. (In re Vitro)*, 2012 Bankr. LEXIS 2682, Case No. 11-33335-HDH-15, Adv. No. 12-03027 (Bankr. N.D. Tex. June 13, 2012).
2 *Id.* at *43.
3 The Bankruptcy Court stayed its decision for two weeks to allow Vitro time to appeal and to seek a stay on appeal. On June 19, Vitro sought appeal of the Bankruptcy Court's decision directly to the United States Court of Appeals for the Fifth Circuit.

Background and the Bankruptcy Court's Decision

Although the proceedings involving Vitro took several procedural twists and turns and involved simultaneous litigation in Mexico, Texas and New York, the underlying facts are relatively straightforward. Vitro owed more than $1.7 billion to noteholders under several series of indentures. The notes were guaranteed by Vitro's US subsidiaries. As a result of the occurrence of defaults under the indentures, Vitro filed for protection under the *Ley de Concursos Mercantiles (LCM)*, the Mexican restructuring law, and its foreign representative subsequently filed for protection under Chapter 15 of the Bankruptcy Code. Chapter 15 of the Bankruptcy Code provides a mechanism for US bankruptcy courts to recognize and enforce the orders of bankruptcy courts in foreign jurisdictions, subject to the statutory limitation that such order is not "manifestly contrary to the public policy of the United States."[4] The US non-debtor subsidiaries did not file for protection under the *LCM* or the Bankruptcy Code.

The restructuring plan filed by Vitro in Mexico under the *LCM*, called a *Concurso* plan, contemplated, among other things, the release of the guarantees provided by the US non-debtor subsidiaries. As part of Vitro's efforts to ensure that the *Concurso* plan obtained the requisite acceptances from creditors, Vitro issued bonds to insiders, including to its non-debtor subsidiaries, and the votes of those insiders were cast and counted.

After the Mexican court entered an order approving the *Concurso* plan, the foreign representative filed on behalf of Vitro a motion seeking an order from the Bankruptcy Court to enforce the *Concurso* approval order and enjoin the noteholders from pursuing remedies against the US non-debtor subsidiaries whose guarantees were being released under the *Concurso* plan. The noteholders objected to the motion on several grounds, including that the *Concurso* plan improperly released claims against non-debtors in violation of US public policy. Vitro argued that as a matter of comity the Bankruptcy Court should defer to the Mexican court and enforce the releases in the *Concurso* plan approved by the Mexican court.

The Bankruptcy Court agreed with the noteholders. The Bankruptcy Court relied on three grounds for denying the foreign representative's motion to enforce the *Concurso* plan.[5]

First, it concluded that it could not provide "additional assistance" to a foreign representative under Section 1507 of the Bankruptcy Code because the *Concurso* approval order did not provide for "a distribution of proceeds of the debtor's property substantially in accordance with the [Bankruptcy Code]."[6] The

4 11 U.S.C. § 1506.

5 The Bankruptcy Court overruled the noteholders' objections that the Mexican judicial system is corrupt, the process was unfair or that there were violations of Mexican law, finding either insufficient evidence to sustain those objections or that they were better left for the Mexican court to adjudicate under Mexican law.

6 *Id.* at *40.

Concurso plan would accord vastly different treatment to creditors than under the Bankruptcy Code: not only would the noteholders receive a substantially smaller distribution under the *Concurso* plan, but their claims against Vitro's subsidiary guarantors would be effectively extinguished. Under Chapter 11, they would be free to pursue those claims.

Second, the Bankruptcy Court concluded that the *Concurso* approval order ran afoul of Section 1521 of the Bankruptcy Code because the order neither sufficiently protected the interests of US creditors nor provided an appropriate balance between the interests of creditors and Vitro and its non-debtor subsidiaries.

Finally, the Bankruptcy Court held that the non-consensual third party releases contemplated by the *Concurso* approval order contravened a fundamental US public policy. Because the phrase "manifestly contrary to the public policy of the United States" is not defined in the Bankruptcy Code, the Bankruptcy Court relied on the legislative history of the applicable Bankruptcy Code provision and recent case law. Although the Bankruptcy Court acknowledged that the "manifestly contrary" limitation should "be applied narrowly" and "invoked only when fundamental policies of the United States are at risk," it found that the "protection of third party claims in a bankruptcy case is a fundamental policy of the United States."[7] The Court found support for its conclusion from Congress through its enactment of Section 524 of the Bankruptcy Code and from the Fifth Circuit through its per se prohibition of non-consensual third party releases in Chapter 11 plans.

Notably, the Bankruptcy Court did not follow a recent decision involving third party releases issued by the United States Bankruptcy Court for the Southern District of New York in the Chapter 15 case of *In re Metcalfe & Mansfield Alt. Invs.*[8] In that case the Bankruptcy Court determined that Section 1506 does not bar the enforcement of third party releases contained in a Canadian plan. The Vitro Bankruptcy Court distinguished the facts before it from Metcalfe, noting that in Metcalfe there was near unanimous approval of the plan by creditors who were not insiders, the plan was negotiated between the parties, there was no timely objection to the order and the release was narrower.

On that basis, the Bankruptcy Court denied the foreign representative's motion to enforce the *Concurso* plan approval order, thereby permitting the noteholders to pursue remedies against the US non-debtor subsidiaries who guaranteed their debt.

Impact

If the Court's decision is upheld on appeal and, particularly, if followed in other US jurisdictions, the decision is a victory for lenders who have loaned money to

[7] *Id.* at *41.
[8] 421 B.R. 685 (Bankr. S.D.N.Y. 2010).

non-US borrowers and have relied in part on the ability to collect from the US subsidiary guarantors of those borrowers if there is a default. This may be an issue that is confronted more often in the coming years in the context of restructuring negotiations with non-US borrowers who have assets or subsidiaries in the US potentially subject to judgment or seizure by US creditors.

Nevertheless, the Vitro Bankruptcy Court decision leaves unanswered questions. For example, the Bankruptcy Court decision does not analyze the decisions of other Circuits where the standard for approving third party non-consensual releases is less stringent than the per se prohibition on third-party releases announced by the Fifth Circuit. As a result, it is unclear whether a court can simply rely on the law in its Circuit to determine whether an order contravenes the "public policy of the United States" where there are differences among the Circuits on a point of law (as is the case in respect of the circumstances under which it is appropriate to approve non-consensual third party releases).

Finally, although the Bankruptcy Court clearly overruled the noteholders' objections on the basis of purported unfairness and defects in the *Concurso* plan approval process, it is unclear if the Court's conclusion would have been affected if there were no such allegations about the process.

Contacts

For further information please contact:

Martin Flics
Partner
(1 212) 903 9022
martin.flics@linklaters.com

Paul Hessler
Partner
(1 212) 903 9132
paul.hessler@linklaters.com

Robert Trust
Counsel
(1 212) 903 9217
robert.trust@linklaters.com

Aaron Javian
Associate
(1 212) 903 9148
aaron.javian@linklaters.com

Edward Rasp
Associate
(1 212) 903 9223
edward.rasp@linklaters.com

Nancy Chu
Associate
(1 212) 903 9047
nancy.chu@linklaters.com

Sarah Barnard
Associate
(1 212) 903 9413
sarah.barnard@linklaters.com

1345 Avenue of the Americas
New York, NY 10105

Telephone (1 212) 903 9000
Facsimile (1 212) 903 9100