Bankruptcy, Restructuring & Commercial Law Advisory

DECEMBER 20, 2012

Bankruptcy Abroad: US Creditors' Rights Remain Relevant in Chapter 15

BY KEVIN J. WALSH AND ERIC R. BLYTHE

With an increasing number of businesses operating without regard to borders in today's global economy, the importance of understanding Chapter 15 — the Bankruptcy Code provisions instructing the cooperation between the United States and courts of foreign lands involved in cross-border insolvency cases — has never been greater. This advisory will touch on the scope of Chapter 15 and its attempt to balance comity and domestic legal policy, as highlighted in the recent Fifth Circuit Court of Appeals decision, *Ad Hoc Group of Vitro Noteholders v. Vitro SAB de CV*, No. 12-10542 (5th Cir. Nov. 28, 2012).

The relevant facts can be summarized as follows: From 2003 to 2007, Vitro S.A.B. de C.V. ("Vitro"), Mexico's largest glass manufacturer, borrowed approximately $1.2 billion predominately from US investors ("Old Notes"). The Old Notes were guaranteed by Vitro's subsidiaries (the "Guarantors"). The guarantees provided that they would not be released in any bankruptcy proceeding affecting Vitro and that Mexican law would not apply. In December 2009, a series of financial transactions wiped out subsidiary debt (owed to Vitro) and resulted in Vitro's subsidiaries becoming its creditors, to the tune of approximately $1.5 billion. These transactions were revealed approximately 300 days after their completion, thereby bypassing Mexico's 270-day "suspicion period" in which the transactions could be voided.

On December 13, 2010, Vitro began bankruptcy proceedings in Mexico. Under the terms of the proposed restructuring plan ("Plan"), the Old Notes would be extinguished, the Guarantors' obligations would be discharged, and existing equity would retain its ownership position. Under Mexican law, Plan approval required support of at least 50% in aggregate principal amount of unsecured debt and, although 74.67% approved the Plan, over 50% of all voting claims were held by Vitro's subsidiaries; thus, the Plan would not have been approved without the votes of the subsidiaries. Thereafter, Vitro filed a motion in the US Bankruptcy Court in the Northern District of Texas to enforce the Plan (the "Enforcement Motion") over the assets and creditors located in the US. The Bankruptcy Court denied the Enforcement Motion and the case eventually rose to the Fifth Circuit Court of Appeals.

Chapter 15 is intended to provide effective mechanisms for dealing with cases of cross-border insolvency. The central theme of Chapter 15 is comity — the recognition by one nation of the legislative, executive, or judicial acts of another, having due regard both to international duty and convenience, and to the rights of its own citizens, or of other persons who are under the protections of its laws. The *Vitro* decision turns on this difficult balance between the interests of the US, the interests of the foreign state, and the mutual interests in efficiently functioning rules of international law.

The Court began by acknowledging that the mere fact that requested relief is unavailable under US law is not grounds for denying comity. In fact, Chapter 15 is intended, at times, to provide relief not otherwise available under US law. However, the Court explained that Chapter 15 imposes certain requirements and considerations that act as a brake or limitation on comity. One such limitation is that a court must consider whether the foreign relief is comparable to that available under the Bankruptcy Code. It was this analysis which led to the denial of Vitro's enforcement action.

Vitro's requested relief, the discharge of the obligations held by the non-debtor Guarantors, was theoretically permitted under Chapter 15 despite it not being available in the Fifth Circuit and only rarely available in other jurisdictions (*see In re Dow Corning Corp.*, 280 F.3d 648 (6th Cir. 2002) (release is a dramatic measure only permitted when seven factors are present); *In re Specialty Equip. Cos.*, 3 F.3d 1043 (4th Cir. 1993) (must be consensual and bind only those voting in favor of the plan); *In re A.H. Robins Co., Inc.,* 880 F.2d 694 (4th Cir. 1989) (creditors opting out had claims fully satisfied)). This "rare availability" provided the Court with a comparable situation and a clear standard that Vitro needed, but failed, to meet. Instead, the Court found that the Plan did not provide for an appropriate balance among the interest of Vitro, its creditors, and the Guarantors; equity retained substantial value; creditors did not receive distribution close to what they were originally owed; affected creditors did not consent to the Plan and were outweighed only by insider votes; and non-consenting creditors were not given an alternative to recover what they were owed in full. Overall, the Court held that Vitro did not meet its burden of showing that the relief requested was substantially in accordance with the circumstances that would warrant such relief in the US.

This case illustrates the wide applicability of Chapter 15 — nearly any foreign action arising from an authorized foreign proceeding falls within its scope and is potentially enforceable in the US. However, despite its central theme of comity, courts will not use Chapter 15 to toss aside long established tenets of the Bankruptcy Code and US law in general. By tying the analysis to comparable proceedings even when the requested relief escapes US legal boundaries, Chapter 15 ensures that basic protections remain.

If you have any questions about this decision or its implications, please call your principal Mintz Levin attorney or one of the attorneys noted on this advisory.

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2488-1212-NAT-BRC