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Bankruptcy Court Rules a Foreign Insolvency Plan That Extinguishes Claims Against Non-debtor Subsidiaries is Manifestly Contrary to US Public Policy

In a decision further defining when US public policy restricts the relief a court may grant in aid of a foreign restructuring or insolvency proceeding, the Bankruptcy Court in the Chapter 15 case of *Vitro, S.A.B. de C.V.* v. *ACP Master, Ltd. (In re Vitro, S.A.B. de C.V.)*, Ch. 15 Case No. 11-33335-HDH-15, 2012 WL 2138112 (Bankr. N.D. Tex. Jun. 13, 2012) refused to a enforce a Mexican restructuring plan that novated and extinguished the guaranty obligations of the Mexican debtor's non-debtor subsidiary guarantors. Finding that the protection of third party claims in a bankruptcy case constituted a fundamental US public policy, the court denied the foreign representative's request to give full force and effect in the US to the Mexican restructuring plan; it also denied the foreign representative's request to grant a permanent injunction prohibiting suits in the US against the non-debtor guarantors.

First, a bit of background about the debtor. Vitro, S.A.B. de C.V. ("Vitro") is a Mexican holding company that conducts substantially all of its multinational operations through subsidiaries. It is Mexico's largest manufacturer of glass containers and flat glass, with manufacturing facilities in eleven countries and distribution centers throughout the Americas and Europe.[1]

On December 13, 2010, Vitro filed a voluntary judicial reorganization proceeding (the "Mexican Proceeding") under the *Ley de Concursos Mercantiles, the* Mexican business reorganization act, seeking approval of a pre-packaged "*concurso*" restructuring plan (as modified and approved, the "Mexican Plan").[2] Vitro's reorganization process has been anything but smooth. After significant procedural wrangling not relevant to the issues here, the Mexican court presiding over the Mexican Proceeding entered an order approving the Mexican Plan (the "Approval Order") on February 3, 2012. The Approval Order modified Vitro's debts owed to the noteholders under various indentures. In addition, it novated and extinguished the guarantees, effectively discharging the obligations of Vitro's non-debtor subsidiary guarantors to the noteholders.[3] Notwithstanding entry of the Approval Order, Vitro's noteholders continued to take actions in New York against Vitro's non-debtor

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[1] *Vitro, S.A.B. de C.V.* v. *ACP Master, Ltd. (In re Vitro, S.A.B. de C.V.)*, 455 B.R. 571, 574 (Bankr. N.D. Tex. 2011).

[2] *Id.*

[3] *Vitro, S.A.B. de C.V.* v. *ACP Master, Ltd. (In re Vitro, S.A.B. de C.V.)*, Ch. 15 Case No. 11-33335-HDH-15, 2012 WL 2138112, at *2 (Bankr. N.D. Tex. Jun. 13, 2012).

subsidiaries, attempting to collect their debts owed under the various guarantees to indentures Vitro issued.[4]

In response, Vitro's foreign representative filed a motion in the Chapter 15 Cases asking the Bankruptcy Court to give full force and effect in the US to the Approval Order, and grant a permanent injunction prohibiting actions in the US against Vitro, as well as to its non-debtor subsidiaries.

The noteholders objected on numerous grounds. They argued that the Mexican Plan discriminated between foreign and non-foreign creditors, failed to reasonably assure the prevention of fraudulent transfers, and failed to distribute the proceeds of the estate in substantial accordance with the Bankruptcy Code. The noteholders also argued that enforcing the Mexican Plan violates US public policy because, among other things, it discharges non-debtor debts and violated many, if not all of the protections afforded to creditors under the Bankruptcy Code.[5]

Before turning to the arguments, let's pause to consider Chapter 15 of the Bankruptcy Code ("Chapter 15") and the relief it provides.[6] Chapter 15 endows a court with broad discretion to grant relief in aid of a foreign insolvency or restructuring proceeding to facilitate the rescue of foreign financially troubled businesses.[7] A court may, for example, entrust assets located in the US to the foreign representative of a foreign debtor, enjoin the commencement or continuation of law suits in the US against the debtor or its assets, and provide for an extended application of the automatic stay in the US with respect to the debtor.[8] Consistent with the principles of comity, the court may also grant "additional assistance" to the foreign representative – a flexible and wide-reaching catch-all provision authorizing relief in favor of the foreign proceeding – provided certain statutory requirements are satisfied.[9] Since its enactment, foreign representatives have successfully used Chapter 15's flexibility to support non-US proceedings, including by way of enforcing non-US restructuring plans and injunctions in the US.[10]

But Chapter 15 has its limits. If, for example, a court entrusts all or part of a debtor's assets located in the US to the foreign representative, the court must be satisfied that the interests of creditors in the US are sufficiently protected.[11] When providing additional assistance, the

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4 *Id.*

5 *Id.* at *10-11.

6 The US Congress adopted the United Nations Commission on International Trade Law Model Law on Cross-Border Insolvency by enacting Chapter 15 of the Bankruptcy Code in 2005. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (2005).

7 *See* 11 U.SC. § 1501.

8 11 U.S.C. § 1521(a).

9 11 U.S.C. § 1507.

10 *See, e.g., In re Metcalfe & Mansfield Alt. Invs.,* 421 B.R. 685 (Bankr. S.D.N.Y. 2010).

11 11 U.S.C. § 1521(b).

court must also consider whether such assistance reasonably assures, among other things, the just treatment of all holders of claims against or interests in the debtor's property, as well as a distribution of proceeds of the debtor's property substantially in accordance with what a US bankruptcy case would provide.[12] Finally, a court may always deny Chapter 15 relief if the relief is manifestly contrary to US public policy, a concept the Bankruptcy Code does not define.[13]

Courts universally agree that Congress intended Chapter 15's public policy exception to apply only to the most *fundamental policies* of the U.S. Only a handful of chapter 15 opinions have considered the scope of the exception to date. All have concluded that the mere fact that application of foreign law leads to a different result than application of U.S. law is, without more, insufficient to deny comity. Instead, as at least one District Court has emphasized, section 1506 of the Bankruptcy Code requires the bankruptcy court to determine whether the foreign proceeding was "procedurally unfair," and whether the application of foreign law or the recognition of a foreign main proceeding would "severely impinge" a U.S. statutory or Constitutional right in a way that would offend "the most fundamental policies and purposes" of such right.[14]

Where did the Vitro *concurso* cross the line?

In discussing the public policy exception, the Bankruptcy Court expressly agreed with courts that read the provision narrowly and applied it sparingly.[15] It further appeared to endorse the conclusion that only relief that severely impinges a US constitutional or statutory right would fall within the exception.[16]

The Bankruptcy Court, however, was clearly troubled by Vitro's ability to extinguish the noteholders claims against non-debtor subsidiaries -- entities that did not file for bankruptcy protection in Mexico or the US -- through the Mexican Plan.[17] It noted the general policy of the US, as embodied in Section 524 of the Bankruptcy Code, against the discharge of claims for entities other than a debtor in an insolvency proceeding, absent the existence of extraordinary circumstances.[18] The Bankruptcy Court found no circumstances warranted an exception in Vitro's case. It further cited US case law in the Fifth Circuit that has largely foreclosed non-consensual non-debtor releases and permanent injunctions outside the

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[12] 11 U.S.C. § 1507(b).

[13] 11 U.S.C. § 1506.

[14] *Micron Tech., Inc.* v. *Qimonda AG (In re Qimonda AG Bankruptcy Litig.)*, 433 B.R. 547, 568-69 (E.D. Va. 2010).

[15] *In re Vitro,* 2012 WL 2138112, at *4.

[16] *Id.* at *5.

[17] *Id.*at *12.

[18] Section 524(e) of the Bankruptcy Code provides: "Except as provided in subsection (a)(3) of this section, discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt."

context of mass tort claims being channeled toward a specific pool of assets.[19] In the end, the Bankruptcy Court concluded that the Bankruptcy Code, coupled with the Fifth Circuit case precedent, revealed a fundamental US policy to protect third party claims in a bankruptcy case. Because the Mexican Plan did not recognize and protect such rights, the Bankruptcy Court held that it was manifestly contrary to US policy within the meaning of the Chapter 15 public policy exception and could not be enforced in the US.[20]

The Bankruptcy Court denied the foreign representative's enforcement motion for two additional reasons, both of which it found violated other provisions of Chapter 15. First, it found that the Mexican Plan did not distribute the debtor's assets substantially in accordance with the Bankruptcy Code, since it cut off the noteholders' rights against the non-debtor subsidiaries and only provided for a partial distribution on the notes themselves. Second, for essentially the same reasons, it found that the Approval Order did not sufficiently protect the interests of creditors in the US, or provide an appropriate balance between the interests of such creditors, Vitro, and the non-debtor subsidiaries.[21]

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The Bankruptcy Court's ruling is one of the few Chapter 15 decisions limiting the scope of discretionary relief a bankruptcy court may grant in aid of a foreign proceeding as a matter of US public policy. Significantly, the Bankruptcy Court was not swayed by the numerous allegations and arguments that the Mexican process was corrupt, procedurally deficient, unfair, or that the Mexican Proceeding specifically violated Mexican law and process. To that extent, the Bankruptcy Court's opinion does not reveal a parochial or territorial bias. Indeed, the Bankruptcy Court went out of its way to find that reorganization pursuant to Mexican law is generally "a fair process, worthy of respect."[22] It also concluded that the Mexican court should appropriately resolve arguments based on Mexican law and rights in Mexico, including allegations of voting irregularities in the Mexican Proceeding.

On the other hand, the Bankruptcy Court's elevation of a narrow Bankruptcy Code provision– that a discharge of the debtor's debt does not affect the liability of third parties on the same debt – to the level of a fundamental US public policy, without any discussion or evidentiary showing that such provision impacts a wider public interest, may open the door to similar arguments anytime a difference exists between foreign and US insolvency law. Notably, the Bankruptcy Court dismissed the noteholders' objections based on the potential adverse impact that enforcement in the US of the Mexican Plan might have on US financial markets, a concern that more closely aligns with traditional notions of "public interest." Instead, it turned to a very narrow US bankruptcy provision and concluded, without much analysis, that the general prohibition against discharge of third party claims in US bankruptcies revealed a

[19] *Id.*

[20] *Id.* at *13.

[21] *Id.*

[22] *Id.* at *14.

fundamental US public policy that could not be violated even if foreign law otherwise permits the result.

In the end, an appellate court may well weigh in on the debate. The Bankruptcy Court stayed its decision, and maintained an existing temporary restraining order, to allow Vitro time to appeal and to seek a stay on appeal.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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