Vitro's Mexican Plan of Reorganization Denied Comity in the U.S.

In a Chapter 15 case presenting interesting considerations for cross border lenders and borrowers, the Bankruptcy Court for the Northern District of Texas ("Bankruptcy Court") declined to implement in the United States the Vitro plan of reorganization that had been approved by a Mexican court, because the plan (i) did not provide for distributions to noteholders consistent with Chapter 11, (ii) did not sufficiently protect the interests of U.S. creditors, and (iii) did not protect the noteholders' third-party claims against non-debtor subsidiaries, instead releasing those claims. The Bankruptcy Court held that the distributions provided under the Mexican plan were not entitled to comity and the third-party releases were contrary to public policy of the United States. [1] The *Vitro* decision has interesting implications which we discuss in this Client Update.

Factual Background

Vitro, S.A.B. de C.V. ("Vitro") is the largest manufacturer of glass containers and flat glass in Mexico and one of Mexico's leading multinational companies, with subsidiaries throughout the Americas and Europe. In February 2009, Vitro defaulted on $1.5 billion in debt and began restructuring negotiations with its noteholders. During the negotiations, Vitro engaged in various intercompany transactions with its subsidiaries which, as a result, became creditors of the estate and were given the ability to cast votes on a restructuring plan on the account of intercompany claims worth $1.9 billion.

Mexican Proceedings

In November 2010, Vitro began soliciting votes for a prepackaged plan of reorganization in Mexico, and in December 2010, Vitro filed for voluntary reorganization in a Mexico district court seeking approval of a prepackaged "*concurso mercantil*" reorganization plan which contemplated the financial restructuring of its debt. The Mexican Business Reorganization Act (*Ley de Concursos Mercantiles*) requires that, for a prepackaged restructuring agreement to be filed by the debtor at the commencement of a *concurso mercantil* case, it must have the preliminary approval of creditors representing at least 40 percent of the claims. The Mexican court initially denied Vitro's *concurso mercantil* petition because the proposed plan included intercompany claims in the calculation of the creditor claim percentage, however a Mexican appellate court found the plan to meet the statutory requirement and ordered the commencement of the case, appointing a conciliator with the role of reviewing the claims and assisting Vitro in reaching an agreement with the creditors. At the completion of the conciliator's review, the Mexican court issued a decision recognizing the ranking and amount of each claim. Such decision reflected the treatment provided in Vitro's initial *concurso* plan pursuant to which the subsidiaries' intercompany claims were allowed and the noteholders would recover only an estimated 60% of the value of their bonds. In response, the noteholders put forth an alternative plan; however, the conciliator submitted in response a revised plan that was even less favorable to creditors and particularly to dissenting creditors. The conciliator's plan (the "Mexican Plan") paid the noteholders below par, granted recovery for equity holders, decreased recovery for any dissenting creditors, and included releases for non-debtor subsidiaries.[2] In February 2012, the Mexican court approved of the Mexican Plan.

[1] *In re Vitro, S.A.B. de C.V.*, No. 11-33335-HDH-15, 2012 Bankr. Lexis 2682 (Bankr. N.D. Tex. June 13, 2012), *modified by* No. 11-33335-HDH-15 (Bankr. N.D. Tex. June 15, 2012).

[2] These releases were especially relevant in connection with the financial restructuring contemplated in the Mexican Plan because many subsidiaries had guaranteed the debt of Vitro.

United States Proceedings

Before the Mexican *concurso* was filed in Mexico, Vitro creditors had filed involuntary Chapter 11 petitions in Texas against 15 of Vitro's U.S. subsidiaries. Shortly thereafter, two of Vitro's largest bondholders, Aurelius Capital Management, LP and Elliot Management Corp. commenced lawsuits in New York Supreme Court against Vitro and 49 of its subsidiaries in their capacity as guarantors of Vitro's notes for breach of contract with respect to their guarantees. In an attempt to stay the bondholders' suit in New York, Vitro filed a Chapter 15 petition in the SDNY bankruptcy court which was withdrawn prior to any decision after the *concurso* was initially denied by the Mexican court. The Chapter 15 case was re-filed in the SDNY after the Mexican appellate court issued its decision commencing the *concurso mercantil*, but was then transferred from the SDNY to the Bankruptcy Court in Texas once certain of the Vitro's subsidiaries that were initially subject to involuntary Chapter 11 petitions became Chapter 11 debtors before the Bankruptcy Court. In July 2011, the Bankruptcy Court recognized the Mexican proceeding as a "foreign main proceeding" under Chapter 15.[3] In March 2012, after the Mexican Plan had been approved by the Mexican court, Vitro's foreign representative moved the Bankruptcy Court seeking the enforcement and recognition of the Mexican Plan in the United States as a matter of comity, and three groups of noteholders each filed objections.

Discussion

A U.S. bankruptcy court overseeing a Chapter 15 proceeding will provide any additional assistance to the foreign representative of a foreign debtor consistent with principles of comity (e.g., in particular, just treatment of all holders of claims against the foreign debtor and protection of U.S. claim holders against prejudice and inconvenience in the processing of claims).[4] A U.S. bankruptcy court, however, will not take any action that would be manifestly contrary to an important public policy of the United States.[5] Provided that the assistance requested by the foreign representative is consistent with principles of comity and is not against public policy, then recognition of the orders issued by the foreign court is generally possible.

The Bankruptcy Court engaged in the review of the bases upon which a Chapter 15 court may provide additional relief to protect the assets of the foreign debtor or the interest of the creditors. Citing *Hilton v. Guyot*, 159 U.S. 113 (1895), the Bankruptcy Court observed that "[g]ranting comity to judgments in foreign bankruptcy proceedings is appropriate as long as U.S. parties are provided the same fundamental protections that litigants in the United States would receive"[6] and that "[t]he principle of comity has never meant categorical deference to foreign proceedings . . . . [D]eference should be withheld where appropriate to avoid the violation of the laws, public policies, or rights of the citizens of the United States."[7] The Bankruptcy Court also engaged in extensive review of case law addressing the public policy exception under Bankruptcy Code Section 1506,[8] on which the parties had briefed extensively.

Finding no evidence of corruption in the Mexican proceeding or in the *concurso mercantil* process per se, the Court denied the noteholders' objections that a Mexican court's rulings should not be given comity on

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[3] *In re Vitro*, *S.A.B. de C.V.*, No. 11-33335-HDH-15 (Bankr. N.D. Tex July 21, 2011) (order granting recognition of Mexican proceeding as "foreign main proceeding" under Chapter 15).

[4] Bankruptcy Code Section 1507.

[5] Bankruptcy Code Section 1506.

[6] *In re Vitro*, 2012 Bankr. Lexis 2682, at *11.

[7] *Id*. (quoting *In re Treco*, 240 F. 3d 148, 157 (2d Cir. 2001)).

[8] *Id*. at *12-32.

account of allegations of corruption throughout the Mexican judicial system. The Court also denied the claim that the Mexican Plan would have an impact on the financial markets in the United States because, although the IMF economist who had testified in this respect had credibly pointed to the adverse impact on the United States' appeal to foreign issuers, the witness had been unable to quantify the effect in a way that would enable the Court to reach a conclusion. Finally, the Court rejected the arguments that the *concurso mercantil* process and the Mexican proceeding specifically were generally unfair, opining that such arguments would be for a Mexican court to consider.[9]

The Court denied Vitro's motion for recognition and enforcement of the Mexican Plan. The Court expressed concerns about plans that would be protective of non-debtor subsidiaries that had guaranteed United States indentures, and concluded that the protection "against discharge of claims for entities other than a debtor in an insolvency proceeding, absent extraordinary circumstances," is a public policy expressed in Fifth Circuit precedents.[10] Because the Mexican Plan would entirely extinguish claims against such non-debtor guarantors, it was "manifestly contrary" to such policy, according to the Court.[11] The Court also observed that the Mexican Plan, by failing to strike an appropriate balance between the interests of the creditors of Vitro (debtor) and the interest of the creditors of the non-debtor Vitro subsidiaries, failed to sufficiently protect the interests of creditors in the United States as required under Bankruptcy Code Section 1521. In an interesting passage that will certainly attract the attention of Chapter 15 and cross border insolvency commentators, the Court also held that the Mexican Plan did "not provide for the distribution of proceeds of the debtor's property substantially in accordance with the order prescribed by Title 11," as required under Bankruptcy Code Section 1507(b)(4), noting that "[u]nder a Chapter 11 plan, the noteholders would receive their distribution from the debtor and would be free to pursue their other obligors, in this case the non-debtor guarantors," whereas the Mexican Plan provided for "drastically different treatment."[12]

Demonstrating the limited utility of *Vitro* to other circumstances, the Bankruptcy Court rejected the noteholders' arguments that comity should not be afforded based on widespread dissimilarities of the Mexican court system or Mexican law, including alleged procedural deficiencies.[13] The Court explained that "[g]enerally reorganization pursuant to [Mexican law] is found to be a fair process, worthy of respect," finally concluding that "[i]n other and subsequent cases this Court would expect that [Mexican decisions] would be enforced in this country."[14] Nevertheless, the Court's reasoning seems to favor an expansive application of general Bankruptcy Code principles to ancillary and cross border cases, which expansive application could in some cases yield a result inconsistent with Chapter 15 objectives.

In *dicta*, the Court expressed concern about two additional objections against the Mexican Plan, which concerns the Court noted for the appellate court. First, the Court noted that distributions under the

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[9] *Id*. at *36-38.

[10] *Id*. at *38. Other Circuits do not share the Fifth Circuit's view that third-party, non-debtor releases are impermissible absent extraordinary circumstances. *See*, *e.g.*, *In re Drexel Burnham Lambert Grp.*, 960 F.2d 285, 293 (2d Cir. 1992) (upholding third-party releases in favor of directors and officers that were essential to debtor's reorganization and key component of settlement); *In re DBSD N. Am.*, *Inc.*, 419 B.R. 179, 217-18 (Bankr. S.D.N.Y. 2009), *aff'd*, 2010 WL 1223109 (S.D.N.Y. Mar. 24, 2010), *aff'd in part*, *rev'd in part*, 634 F.3d 79 (2d. Cir. 2011) ("Third-party-releases are permissible under some circumstances, but not as a routine matter"); *In re Charter Commc'ns*, 419 B.R. 221, 257 (Bankr. S.D.N.Y. 2009) (confirming a plan containing debtor releases and explaining that, when reviewing debtor releases, courts consider "whether such releases are in the best interest of the estate.").

[11] *Id*. at *38.

[12] *Id*. at *41.

[13] *Id*. at *36-38.

[14] *Id*. at *43.

Mexican Plan would be "demonstrably different than would occur in Chapter 11" because equity claims would retain a value of approximately $500 million while the noteholders would not be paid in full, which result, the Court observed, in the United States could be in violation the absolute priority rule.[15] Second, the Court observed that allowing "insiders"—namely the subsidiaries—to vote on the plan on the basis of bonds that had been issued to them shortly before the *concurso* was initiated was potentially problematic, but concluded that this issue was one of Mexican law and for a Mexican court to decide.[16]

In consideration of the novel questions of law involved, the Bankruptcy Court has certified the *Vitro* decision for direct appeal to the Court of Appeals for the Fifth Circuit.

Future Implications

The *Vitro* decision is limited by the facts of the case. For example, it is not at all clear whether other courts would find that third-party releases contained in a Chapter 11 plan of reorganization violate a fundamental policy of the United States. That the third-party releases contained in the Mexican Plan eliminated guarantees of U.S.-issued debt was surely relevant.

Whether the Trust Indenture Act, by regulating publicly issued bonds, incorporates the policy of the United States with respect to such instruments and the ability of a holder to protect his rights is an interesting argument that would have benefited from more extensive discussion in the *Vitro* decision. A different question, which is also unanswered, is whether such policy would qualify as a fundamental policy under the public policy exception contained in Bankruptcy Code Section 1506. Ultimately, this case may involve the fairly unique question of whether a U.S. court should enforce the decision of a foreign court with respect to a claim arising under U.S. law.

Vitro is not the first case filed under the Mexican *concurso mercantil* statute, which became effective in 2000 and was developed in response to the Mexican peso crisis of 1994, but it may be the first case that puts the use of that statute seriously to the test. The Mexican restructuring statute may result in financing implications for Mexican companies that want to raise debt, e.g., whether the Vitro risk that may be created by the Mexican restructuring statute should influence borrowing costs or spreads resulting in a "Vitro premium" to be paid in the form of a higher coupon.[17] But the *Vitro* decision highlights, generally, the importance of analyzing *ex ante* the scenarios and the possible outcomes of a hypothetical debt restructuring effected under the bankruptcy laws of a foreign jurisdiction, where local notions (or the absence thereof) of cramdown, substantive consolidation, claim subordination, claim priority and surcharges may lead to unexpected results. Secured lenders involved in cross border transactions such as OTC derivatives, securities lending and repos already engage in the analysis of the validity, perfection, priority and prompt enforceability of their collateral in the relevant foreign jurisdiction, relying on industry opinions (coordinated by ISDA or other industry associations) or on independent surveys. However, the risks for bondholders are of a different nature and are directly influenced by the mechanics and dynamics of the bankruptcy forum, as *Vitro* shows. Parties considering cross border debt, particularly when they would rely on third-party guarantees, should be aware of the legal risks implicated by these arrangements in the event of the issuer's (or guarantor's) bankruptcy and of the need to engage in robust global credit risk management analysis and risk mitigation techniques.

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[15] *Id*. at *42.

[16] *Id*.

[17] The concept of a "Vitro premium" was probably first discussed by, and is to be attributed to, Robert Rauch, partner & director of research at Gramercy Advisors LLC.

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- See a copy of *In re Vitro, S.A.B. de C.V.*, No. 11-33335-HDH-15, 2012 Bankr. Lexis 2682 (Bankr. N.D. Tex. June 13, 2012), *modified by* No. 11-33335-HDH-15 (Bankr. N.D. Tex. June 15, 2012).

If you have any questions regarding the matters covered in this publication, please contact any of the lawyers listed below or your regular Davis Polk contact.

Donald S. Bernstein	212 450 4092	donald.bernstein@davispolk.com
Giorgio Bovenzi	212 450 4260	giorgio.bovenzi@davispolk.com
Timothy Graulich	212 450 4639	timothy.graulich@davispolk.com
Marshall S. Huebner	212 450 4099	marshall.huebner@davispolk.com
Benjamin S. Kaminetzky	212 450 4259	ben.kaminetzky@davispolk.com
James I. McClammy	212 450 4584	james.mcclammy@davispolk.com
Elliot Moskowitz	212 450 4241	elliot.moskowitz@davispolk.com
Brian M. Resnick	212 450 4213	brian.resnick@davispolk.com
Damian S. Schaible	212 450 4580	damian.schaible@davispolk.com
Karen E. Wagner	212 450 4404	karen.wagner@davispolk.com