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Lessons from *Vitro:* Intercompany Claims, the Scope of Chapter 15 and Karma

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In all complex restructurings, there are always lessons to be learned. As the multi-paned and multi-jurisdictional Vitro litigation approaches conclusion, several Vitro lessons warrant examination, in particular the role of intercompany claims in plan acceptance, the scope of comity and Chapter 15 after the Fifth Circuit's decision, and the age old lesson of karma.[1]

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Background

Between 2003 and 2007 in a series of transactions, Vitro S.A.B. de C.V. issued notes totaling approximately $1.2 billion (the ''Notes'', and the holders thereof, the ''Noteholders''). The Notes were guaranteed by substantially all of Vitro S.A.B de C.V.'s subsidiaries (the ''Guarantees''), including certain US subsidiaries (the ''US Guarantors'').

In late 2008, precipitated by the global financial crisis, Vitro's revenues decreased which affected its ability to make scheduled payments on the Notes. After announcing its intention to restructure the Notes, but before commencing formal proceedings (described in more detail below), Vitro entered into a complex sale and leaseback transaction which resulted in substantial intercompany debt owing by Vitro parent to various Vitro subsidiaries (the ''Intercompany Claims'').

In December 2010, Vitro S.A.B. de C.V. and certain of its Mexican subsidiaries (collectively referred to as ''Vitro'') commenced insolvency proceedings in Mexico under the *Ley de Concursos Mercantiles*. Vitro did not include the US Guarantors in the filing, nor did those subsidiaries commence contemporaneous parallel proceedings under US law. Vitro filed a plan of reorganization in the Concurso proceeding (the ''*Concurso Plan*'') which proposed to release creditor claims against non-debtor parties, including the Noteholders' claims against the US Guarantors on account of the Guarantees. Vitro obtained the required 50% creditor approval of this controversial *Concurso Plan* in the relevant

[1] The Bankruptcy Court recently approved a settlement negotiated by the relevant Vitro parties and creditors resolving substantially all of the pending litigation. After the settlement agreement was approved, Vitro filed a petition for a writ of certiorari in the United States Supreme Court for review of the United States Court of Appeals for the Fifth Circuit's denial of enforcement of Vitro's Mexican Concurso plan that provided for releases of non-debtor Vitro subsidiaries. Assuming all conditions precedent to the settlement agreement are met, it is expected this petition for certiorari will be withdrawn.

Mexican court, only by counting the affirmative votes of the Intercompany Claims held by Vitro subsidiaries and affiliates. The voting of insider/intercompany claims in the same class as other unsecured creditors is permissible under Mexican insolvency law.

Certain Noteholders objected to the release of non-debtor guarantors and commenced a series of actions in the United States seeking to enforce the Guarantees. The Noteholders obtained a New York state court judgment and orders of attachment, and the indenture trustee for the Notes obtained a declaratory judgment that the Guarantees remained valid under US law.[2] Some of the Noteholders also filed involuntary bankruptcy petitions against fifteen of the US-domiciled Guarantors.[3] The involuntary petitions were initially rejected. Five of the US-domiciled subsidiaries eventually consented to Chapter 11 relief.[4]

Subsequently, Vitro filed a Chapter 15 petition in the Bankruptcy Court for the Southern District of New York in April 2011.[5] The case was eventually transferred to the Bankruptcy Court for the Northern District of Texas.[6] The Fifth Circuit's decision denying enforcement of the *Concurso Plan*, which generated many headlines and is discussed in more detail below, arose out of this proceeding.

Intercompany Claims

One of the first highlighted concerns in *Vitro* was the ability of the Intercompany Claims to vote in the same class as third-party claims in the *Concurso* proceeding in particular, since without those votes Vitro would not have obtained the requisite creditor approval of the *Concurso Plan*. Voting intercompany claims in the same class is permissible under the relevant Mexican insolvency law, however there were concerns about the circumstances under which the Intercompany Claims arose as well as the timing of disclosure of such claims.

A typical solution to this issue, would be to require that all intercompany claims be subordinated to the financial debt in question. An additional solution which has been incorporated into a few recent Mexican restructurings is the concept of a voting trust over any intercompany claims. Specifically, the current and future intercompany claims would be assigned to a trust, the beneficiary of which is the agent for the financial creditors. In the event of a Mexican insolvency proceeding, the agent beneficiary would vote on any plan or *concurso* in the manner directed by the requisite financial creditors.

Lesson for creditors: every jurisdiction has its own set of insolvency procedures and rules. Even if advertised as ''Chapter 11-like'' that does not mean the provisions are identical to operate like Chapter 11. That is not a bad thing – restructuring does work in other jurisdictions. However, when a provision leads to perceived inequitable results, there is usually a commercial solution for the next deal.

Karma: Shuffling Assets Is a Good Way to Find Yourself in Chapter 11

As noted above, in 2011, certain Noteholders filed involuntary Chapter 11 petitions against fifteen of Vitro's US-domiciled subsidiaries. Five of the subsidiaries ultimately consented to Chapter 11 relief but the other ten continued to resist the petitions. In December 2012, the United States Bankruptcy Court for the Northern District of Texas granted the remaining involuntary Chapter 11 petitions. In doing so, the court held that the US-domiciled subsidiaries' efforts to conceal and transfer assets during the course of the cases provided an independent basis for granting the involuntary petitions under the controlling ''special circumstances'' exception.[7]

The Bankruptcy Court for the Northern District of Texas had initially denied the involuntary petitions, holding that the US-domiciled subsidiaries' obligations were contingent as to liability and that they were generally paying their debts as they became due. The Bankruptcy Code provides that an involuntary petition must be filed by three or more creditors holding claims that are not ''contingent as to liability or the subject of a bona fide dispute as to liability or amount''. Section 303 provides that courts must grant contested involuntary petitions if the debtor is ''generally not paying [its] debts as they become due unless such debts are the subject of a bona fide dispute as to liability or amount.'' The Noteholders successfully appealed that decision to the District Court for the Northern District of Texas. The District Court held that because the relevant indentures waived demand of payment, the obligations were not contingent. The District Court further found that the Bankruptcy Court erred in its determination that the US-domiciled subsidiaries were paying their debts as they became due, noting that payment of multiple invoices constituting less than 1% of the debt outstanding was not sufficient.

On remand, the only remaining issue for the Bankruptcy Court to decide was whether the Noteholders' claims were the subject of a bona fide dispute as to amount. The parties' arguments hinged on whether certain indenture provisions operated as a savings clause or a limitation on guarantor liability. The Bankruptcy Court held that various New York state court judgments involving the parties (recall the multi-paned ongoing litigation) established that the disputed provisions operated as a savings clause and, accordingly, there was no bona fide dispute as to the amount of the Noteholders' claims.

The Bankruptcy Court further, and arguably unnecessarily, invoked the Fifth Circuit's ''special circumstances'' exception to the technical requirements of Section 303(b) of the Bankruptcy Code. Under this exception, a court can grant an involuntary petition even if the statutory requirements are not satisfied ''where there is fraud, trick, artifice or scam by an alleged debtor.'' The court held that the US-domiciled subsidiaries' post-petition conduct triggered the special circumstances exception. Specifically, after the initial dis-

[2] *Wilmington Trust v. Vitro Automotriz, S.A. de C.V. et al*, Supreme Court State of New York, Index No. 652303/2011, Order Nos. 59, 60 and 121

[3] Involuntary Petitions dated Nov. 17, 2010, *In re Vitro Asset Corp.*, Case No. 11-32600 (USBC-NDTX)

[4] The Bankruptcy Court for the Northern District of Texas granted involuntary petitions against the remaining US-domiciled subsidiaries in December 2012. Memorandum Opinion, *In re Vitro Asset Corp.*, Case No. 11-32600 (Bankr. N.D. Tex. Dec. 4, 2012)

[5] Chapter 15 Petition dated April 14, 2011, *In re Vitro S.A.B. de C.V.* , Case No. 11-11754 (USBC-SDNY)

[6] Transfer Order No. 25, *In re Vitro S.A.B. de C.V.* , Case No. 11-11754 (USBC-SDNY)

[7] *Supra*, note iv, at pp. 13-14.

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missal of the involuntary petitions, five of the US-domiciled subsidiaries reformed as Bahamian entities. Also, while the appeal was pending, one of the US-domiciled subsidiaries sold all of its stock to another entity. Despite numerous opportunities, the US-domiciled subsidiaries did not disclose the reincorporations and transfer of stock to the Bankruptcy Court, the District Court or the New York state courts. The Bankruptcy Court concluded that, to the extent it is still valid in the Fifth Circuit, the special circumstances exception applied because the US-domiciled subsidiaries were actively trying to conceal their actions and evade the Noteholders' attempts to collect a debt.[8]

Lesson for Debtors: Karma catches up with you, especially in the equitable court of bankruptcy. Shuffling assets without disclosure is one way to find yourself in Chapter 11.

The Fifth Circuit Decision: The Shattering of a Model of Comity or the Perfect Storm of Public Policy Facts?

Chapter 15 is based on the Model Law on Cross Border Insolvency (the ''Model Law'') promulgated by the United Nations Commission on International Trade Law. The Model Law seeks to provide a framework to address the cross-border nature of businesses and the coordination of insolvency proceedings of a multi-jurisdictional company. The key principles of the Model Law are access to US courts, recognition of a foreign insolvency representative, relief for the orderly fair conduct of the insolvency case, and cooperation as between the international courts.[9] Congress enacted Chapter 15 in 2005, replacing former Section 304 of the Bankruptcy Code. Like its Section 304 predecessor, Chapter 15 provides for the commencement of a US proceeding, parallel to that of a foreign insolvency proceeding, and recognition of the foreign proceeding and the foreign-debtor representatives

Upon recognition of foreign representatives, certain rights are available to Chapter 15 debtors under the Bankruptcy Code. First, certain types of relief provided under Chapter 11 become applicable to the Chapter 15 debtor or the Chapter 15 debtor's property upon recognition. These provisions include, among others, the automatic stay (Section 362), adequate protection (Section 361) and provisions regarding the use or sale of property in the US (Section 363).

Second, and further to the ''automatic relief'', a bankruptcy court has the authority to enter ''appropriate relief'' at the request of a foreign representation where such relief would effectuate the purpose of Chapter 15 and protect the assets of the debtor or the interest of creditors.[10] Section 1520(a) includes a non-exhaustive list of examples of such relief. Section 1522 imposes certain limits on the ''appropriate relief'' available under Section 1521, and provides that (a) relief is only available ''if the interests of the creditors and other interested parties, including the debtor, are sufficiently protected'', and (b) the court may impose conditions on the relief granted under Section 1521.

Third, to the extent that the relief sought is not available under either of the foregoing options, the bankruptcy court is further empowered to provide ''additional assistance'' to a foreign representative under Section 1507(a). This ''additional assistance'' is subject to numerous restrictions set out in 1507(b) and elsewhere in Chapter 15, and must be consistent with the principles of comity. As noted by the Fifth Circuit, and explained in more detail below, relief granted under Section 1507 is ''extraordinary'' in nature and the test for granting such relief is more ''rigorous''.

When it ultimately commenced a Chapter 15 proceeding, Vitro sought bankruptcy court recognition of its foreign representatives, and enforcement of the *Concurso Plan* approved in the Mexican proceeding, including the non-debtor release provisions which, among other things, would have extinguished claims of the Noteholders against the US Guarantors.

After hearing objections from certain Noteholders, the Bankruptcy Court for the Northern District of Texas recognized Vitro's foreign representatives, but denied Vitro's request for orders enforcing the Mexican plan of reorganization.[11] The Bankruptcy Court held that the non-consensual non-debtor releases were not appropriate under any of the relevant Sections of Chapter 15, and that enforcement of such releases would ''manifestly contravene[] the public policy of the United States.'' As further support for its decision, the court cited to Section 1506 as a safety value which limits the extension of comity under Chapter 15 where it would be ''manifestly contrary to the public policy of the United States'' to do so.

The United States Court of Appeals for the Fifth Circuit affirmed the Bankruptcy Court's decision in November 2012.[12] On a broader level, the Fifth Circuit decision emphasizes that Chapter 15 is intended to facilitate comity between US and foreign courts, and that courts should look to the Model Law for guidance as they interpret Chapter 15. Despite acknowledging the broad principles of Chapter 15, the Fifth Circuit held that in certain circumstances comity must yield to established US law and policy. The decision is instructive in that it provides a framework for evaluating future requests for enforcement of foreign orders by clarifying the relationship between Sections 1521 and 1507.

Vitro sought relief under both Sections 1521 and 1507 of the Bankruptcy Code. As noted above these provisions empower a bankruptcy court to provide ''appropriate relief'' and ''additional assistance'' to Chapter 15 debtors.

After a thorough analysis, the Fifth Circuit held that a court confronted by requests for relief under Sections 1521 and 1507 should first consider whether the relief requested is specifically included in the illustrative list of relief available under Section 1521. If the relief is not explicitly provided for there, the court should consider whether the requested relief falls more generally under the Section 1521's grant of ''any appropriate relief''. The court instructed that ''appropriate relief'' is relief that was previously available under Chapter 15's predecessor, Section 304, and that courts should consider whether the relief is otherwise available in the United

[8] *Id.*

[9] http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model.html

[10] *See* 11 U.S.C. § 1521.

[11] *Vitro, S.A.B. de C.V. v. ACP Master, Ltd. (In re Vitro, S.A.B. de C.V.)*, 470 B.R. 408 (Bankr. N.D. Tex. 2012); *Vitro, S.A.B. de C.V. v. ACP Master, Ltd. (In re Vitro, S.A.B. de C.V.)*, 473 B.R. 117 (Bankr. N.D. Tex. 2012).

[12] *Vitro, S.A.B. de C.V. v. ACP Master, Ltd. (In re Vitro, S.A.B. de C.V.)*, Case No. 12-10452, 2012

States. Courts should only consider whether relief would be available under Section 1507 if it is not available under Section 1521.

Applying this framework, the Fifth Circuit concluded that the requested injunction and release was not one of the types of relief enumerated in Section 1521. The court also concluded that the general power to grant ''any appropriate relief'' under Section 1521 does not permit enforcement of non-consensual, non-debtor releases because they are not generally available in US bankruptcy proceedings.

Next, the Fifth Circuit concluded that the ''additional assistance'' provision of Section 1507 theoretically permits non-consensual, non-debtor releases. However, one of the prerequisites to that relief is that there must be comparable relief available under the Bankruptcy Code. The Fifth Circuit observed that while non-consensual, non-debtor releases are not permitted in the Fifth Circuit, they are available in other circuits. The Fifth Circuit therefore reviewed the status of non-debtor releases in other jurisdictions and concluded that even where such releases were permitted, they were only available in unique situations, such as where the affected creditors had consented, where there had been consideration given for the release, and where a channeling injunction to a settlement fund had been established.

The Fifth Circuit reviewed the evidence presented during the bankruptcy court trial and concluded that Vitro did not demonstrate any comparable extraordinary circumstances that would permit enforcement of non-consensual, non-debtor releases in a US bankruptcy proceeding. Instead of extraordinary circumstances in favor of the releases, the court noted a number of facts which supported denial; specifically that objecting creditors would only recover 40% from Vitro under the *Concurso Plan*, but that Vitro shareholders were retaining equity interests valued at $500 million; insider votes (those of Vitro's subsidiaries) had carried the acceptance of the *Concurso Plan*; and that the overwhelming majority of creditors affected by the release were objecting to it.

Having concluded that the relief was not available under Section 1521 or 1507, the Fifth Circuit did not address the issue of whether the releases were ''manifestly contrary'' to the public policy of the United States under Section 1506. Practically, however, looking at the findings of the court, one could *see* how those findings might support such a conclusion.

Despite the Fifth Circuit's decision, comity under Chapter 15 is intact. But as drafted, relief is not blindly granted under Chapter 15 to foreign debtors. Appropriate relief and additional assistance beyond the enumerated relief is permitted if the interests of creditors are protected. This requirement does not mean that the foreign order and law must replicate the US law, but rather that it must not contravene the principles of US law. This is not a case of US creditors wanting Chapter 11 to apply around the globe. The releases objected to by the Noteholders were releases of liability owed *by* a US company not in insolvency proceedings of any kind, *to* a US creditor, *under* a US law governed indenture. As the Fifth Circuit notes, even those jurisdictions that permit non-debtor releases, do so in extraordinary circumstances. Vitro did not present evidence of any extraordinary circumstances, and in fact was the perfect storm of facts supporting denial of such releases.

Lesson for all: Comity lives, but unlike justice, it is not blind. The facts matter.

Conclusion

The Vitro matter involved various parties and litigation in multiple jurisdictions; a certain recipe for lessons to be learned, only a few of which are discussed here. While Vitro earned a lot of print space regarding the Fifth Circuit's decision and the effect on comity and Chapter 15, it is our view that comity is alive and well and foreign representatives and foreign cases will continue to be recognized under Chapter 15. Of course only with the passage of time and the next controversial Chapter 15 case can we be sure that we are right. In the meantime, perhaps the most important lesson of all however, is the value of settlement. Bankruptcy courts are courts of equity and the application of equitable principles can be unpredictable.

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