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BANKRUPTCY PRACTICE

Expert Analysis

Fifth Circuit Crafts New Test For Foreign Debtor Relief

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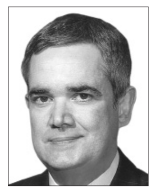

On Nov. 28, 2012, the U.S. Court of Appeals for the Fifth Circuit in *In re Vitro S.A.B. de C.V.*[1] issued a groundbreaking decision under Chapter 15 of the Bankruptcy Code, which provides the mechanics for U.S. bankruptcy courts to deal with cross-border insolvency proceedings. Although deference to judgments of foreign courts is the norm under Chapter 15, in this instance the Fifth Circuit refused to enforce a court-approved Mexican plan of reorganization on the ground that it contained non-consensual non-debtor releases of noteholders' claims against the debtor's non-debtor subsidiaries. Unlike the bankruptcy court below, the Fifth Circuit did not hold that non-consensual non-debtor releases are "manifestly contrary" to U.S. public policy. Instead, the court held that such releases could theoretically be approved in Chapter 15 cases, but only upon a showing of the same type of "exceptional circumstances" that are deemed to justify such releases in U.S.-based cases under Chapter 11.

The Fifth Circuit also developed an impressive new analytical framework for interpreting and reconciling the various provisions of Chapter 15. If adopted by courts in other jurisdictions, the Fifth Circuit's systematic approach to the application of Chapter 15 could prove even more influential than the specific holdings of the case.

Statutory Background

Chapter 15, which was first added to the Bankruptcy Code in 2005, authorizes U.S. bankruptcy courts to assist foreign debtors who are the subject of insolvency proceedings in foreign courts. Section 1521 of the Bankruptcy Code sets forth in detail certain types of relief U.S. bankruptcy courts are authorized to provide to such foreign debtors, including entrusting the distribution of all or part of a foreign debtor's assets located in the United States to the foreign debtor's representative.[2] A bankruptcy court may grant these specific forms of relief only if the interests of creditors are sufficiently protected, however.[3]

A broader provision, Section 1507, authorizes U.S. bankruptcy courts to provide "additional assistance" beyond that expressly authorized in Section 1521. Section 1507 requires a bankruptcy court to consider a series of factors before granting such additional assistance, one of which is whether the assistance will assure a distribution of the debtor's property substantially in accordance with the order prescribed by the Bankruptcy Code.[4]

Finally, Section 1506 creates a "public policy" exception that limits a bankruptcy court's obligation to grant relief under Sections 1521 or 1507. Specifically, Section 1506 provides that a bankruptcy court may refuse to take an action to assist a foreign debtor if that action would be "manifestly contrary" to the public policy of the United States.

Background

Vitro S.A.B. de C.V. is a corporation organized under the laws of Mexico and one of the world's largest glass manufacturers. On Dec. 13, 2010, Vitro commenced a voluntary judicial reorganization proceeding in a Mexican federal court pursuant to Mexico's business reorganization act, the Ley de Concursos Mercantiles. Soon after, Vitro also filed a Chapter 15 petition in the United States. The U.S. Bankruptcy Court for the Northern District of Texas subsequently recognized Vitro's Mexican insolvency proceeding as a foreign main proceeding, making Vitro eligible for relief under Chapter 15. Significantly, although Vitro's subsidiaries had guaranteed almost all of Vitro's debt, most of these subsidiaries were not debtors in either the U.S. or the Mexican proceedings.

On Feb. 3, 2012, the Mexican court entered an order approving a plan of reorganization purporting to extinguish the guarantees of Vitro's non-debtor subsidiaries. Notwithstanding the Mexican plan's release provisions, certain Vitro noteholders proceeded with efforts to enforce the non-debtor subsidiary guarantees in various courts located in the United States. Consequently, Vitro's Chapter 15 foreign representative filed a motion in the Bankruptcy Court requesting that the court give full force and effect to the Mexican plan by enjoining any future attempts to enforce the non-debtor subsidiary guarantees in the United States.

The Bankruptcy Court refused to enforce Vitro's plan, holding that the relief Vitro requested was not available under Section 1521 because it did not sufficiently protect creditors' interests. Enforcement was also not available under Section 1507 because the plan did not assure a distribution substantially in accordance with the order of priority prescribed by the Bankruptcy Code. Finally, the Bankruptcy Court found that Section 1506's public policy exception applied because the plan's non-consensual non-debtor releases were "manifestly contrary" to U.S. public policy as embodied in Fifth Circuit case law, which interprets the Bankruptcy Code to prohibit bankruptcy discharges for non-debtors.

Vitro asked the Fifth Circuit to undertake an expedited review of a single issue—namely, whether the Bankruptcy Court had erred as a matter of law when it refused to enforce Vitro's Mexican plan based solely on its non-debtor release provisions.

The Decision

The Fifth Circuit began its analysis by emphasizing the centrality of "comity" in the context of Chapter 15. The U.S. Supreme Court classically defined this concept as the "recognition which

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one nation allows within its territory to the legislative, executive or judicial acts of another nation."[5] Because of Chapter 15's emphasis on comity, the relief requested by a foreign representative in a Chapter 15 proceeding does not need to be identical to the relief that would be available under U.S. law. Nonetheless, the Fifth Circuit also emphasized that Chapter 15 does place certain limitations on comity, including those that the Bankruptcy Court identified with respect to Sections 1521 and 1507. Because the parties disagreed about which of these provisions was applicable to Vitro's requested relief, and because the relationship between these provisions was "not entirely clear," the Fifth Circuit proposed a new, three-step framework for applying the provisions in conjunction with other relevant provisions of Chapter 15.

The Fifth Circuit's 'Vitro' decision is likely to become a landmark in Chapter 15 jurisprudence because it provides other courts with a systematic, step-by-step approach to applying Chapter 15's key relief provisions.

In the first step of the Fifth Circuit's new framework, a court must consider whether the relief requested by a foreign representative falls into one of the enumerated categories in Section 1521. The Fifth Circuit based this approach on a standard canon of statutory interpretation that dictates that specific terms prevail over general terms. Applying this analysis to the facts before it, the Fifth Circuit determined that it could not order enforcement of Vitro's plan under Section 1521's specific provisions, because a discharge of non-debtor obligations was not one of the specifically enumerated forms of relief.

In the second step, a court must look not at the specific forms of relief enumerated in Section 1521, but rather at general language in Section 1521(a) which states that, at the request of a Chapter 15 foreign representative, a court may grant "any appropriate relief." The legislative history of Section 1521 indicates that the Section was intended neither to expand nor reduce the scope of relief previously available under the statute it replaced, former Bankruptcy Code Section 304, and the Fifth Circuit thus concluded that the appropriate question at this stage of the analysis is whether the requested relief had previously been granted under Section 304. In addition, a court must consider whether the requested relief would otherwise be available under U.S. law.

Applying this analysis, the Fifth Circuit concluded that Section 1521(a)'s "any appropriate relief" language did not provide a basis to enforce Vitro's plan, because there was no precedent for the enforcement of a non-debtor discharge under old Section 304 and Fifth Circuit precedent interprets the Bankruptcy Code as prohibiting such a discharge.

The Fifth Circuit emphasized that a court may move on to the third step of its analysis only if the relief a foreign representative is requesting goes beyond the relief previously available under old Section 304 or currently available under U.S. law. In other words, Section 1507 functions as a "catch-all" that provides for forms of relief "more extraordinary" than those permitted under either the specific or the general provisions of Section 1521. Unlike the Bankruptcy Court, the Fifth Circuit suggested that Section 1507 could theoretically allow for non-consensual non-debtor releases as one such form of extraordinary relief. Nonetheless, the Fifth Circuit remarked that the "devil [was] in the details," and concluded that a non-consensual release was not appropriate under the facts of Vitro's case. For one thing, the Bankruptcy Court had correctly concluded that such a release would not provide for a distribution substantially in accordance with the order of priority prescribed by the Bankruptcy Code.[6] Furthermore, the Fifth Circuit suggested that extraordinary relief under Section 1507 was available only under appropriately extraordinary circumstances, and that Vitro had failed to show the existence of such extraordinary circumstances in its case.

At the conclusion of its analysis, the Fifth Circuit briefly addressed the Bankruptcy Court's holding that non-consensual non-debtor releases are contrary to U.S. public policy under Section 1506. Because the Fifth Circuit had already ruled that neither Section 1521 nor Section 1507 allowed for non-consensual non-debtor releases under the facts of this case, the Fifth Circuit found it unnecessary to actually decide the public policy question. It did, however, express some skepticism about the Bankruptcy Court's holding on this issue. Notably, although non-consensual non-debtor releases are prohibited in the Fifth Circuit, some other U.S. jurisdictions permit them under exceptional circumstances. Based on this fact, the Fifth Circuit observed that it would be difficult to maintain that such releases are "manifestly contrary" to the public policy of the United States as a whole.

Analysis

In its well-reasoned *Vitro* decision, the Fifth Circuit managed to preserve the most important aspects of the Bankruptcy Court's earlier opinion, while simultaneously placing the Bankruptcy Court's rulings on a firmer factual and jurisprudential foundation. To reach its conclusion, the Fifth Circuit balanced the competing interests at play when considering the applicability of controversial relief in the plans of the foreign debtors. On the one hand, there is the key Chapter 15 consideration of respecting foreign law and foreign judgments. On the other hand, Chapter 15 allows U.S. courts to limit their grant of comity to the extent foreign law or foreign judgments contradict the values embodied in U.S. law.

In this instance, the Fifth Circuit balanced comity against the values of U.S. law by holding that non-debtor releases approved by foreign courts might be enforced under Chapter 15, but only under circumstances similar to those under which they would be enforced in the United States.

Ultimately, the Bankruptcy Court's controversial finding that non-consensual non-debtor releases are "manifestly contrary" to U.S. public policy proved questionable in light of the fact that such releases are tolerated under some circumstances in some U.S. jurisdictions. While acknowledging this reality, the Fifth Circuit nonetheless emphasized the rare and extraordinary nature of such releases, sending an important signal to lenders, investors, and the capital markets generally that non-debtor release provisions are as unlikely to be enforced under Chapter 15 as under the other sections of the Bankruptcy Code.

Beyond this specific holding, the Fifth Circuit's *Vitro* decision is likely to become a landmark in Chapter 15 jurisprudence because it provides other courts with a systematic, step-by-step approach to applying Chapter 15's key relief provisions.

Conclusion

Chapter 15 will become ever more important as the U.S. economy becomes increasingly intertwined with the global economy, and the *Vitro* case provides fascinating insight into the difficult balancing act that Chapter 15 requires of U.S. bankruptcy courts. Furthermore, the specific fact pattern in *Vitro* provides a valuable benchmark—where there previously were few—for determining the kinds of foreign plan provisions that may or may not be held enforceable in the United States. It will be interesting to see if and how other courts adapt *Vitro's* framework for interpreting controversial foreign plan provisions under Chapter 15.

1. *Vitro S.A.B. de C.V. v. Ad Hoc Group of Vitro Noteholders, (In re Vitro S.A.B. de C.V.)*, No. 12-10542, 2012 U.S. App. LEXIS 24443 (5th Cir. Nov. 28, 2012).
2. See 11 U.S.C. §1521(b).
3. See 11 U.S.C. §§1521(b), 1522(a).
4. See id. §1521(b)(4).
5. *Hilton v. Guyot*, 159 U.S. 113, 164 (1895).
6. See 11 U.S.C. §1507(b)(4).