FIFTH CIRCUIT'S *VITRO* DECISION FRAMES BASIS FOR RELIEF IN CROSS-BORDER REORGANIZATIONS

I. INTRODUCTION

A recent ruling by the United States Court of Appeals for the Fifth Circuit may have far-reaching implications for distressed companies seeking to ensure a United States bankruptcy court's enforcement of foreign court orders. In In re Vitro, S.A.B. de C.V.,[1] the Fifth Circuit took up the question[2] of whether a bankruptcy court correctly refused to recognize and enforce, pursuant to Chapter 15 of title 11 of the United States Code (the "Bankruptcy Code"), non-consensual third-party releases that were duly authorized pursuant to a Mexican court-approved *concurso*.[3]

In upholding the bankruptcy court's decision refusing to enforce the releases, the Fifth Circuit applied its own Circuit's minority position[4] in Chapter 11 jurisprudence to a question that previously would have been decided, but for the adoption of Chapter 15, pursuant to principles

---

1 Ad Hoc Group of Vitro Noteholders v. Vitro, S.A.B. de C.V. (In re Vitro, S.A.B. de C.V.), No. 12-10542, 2012 WL 5935630 (5th Cir. Nov. 28, 2012) (hereinafter, the "Vitro Opinion").

2 The Fifth Circuit also considered whether a board of directors, as opposed to a foreign court, could effectively appoint a debtor's foreign representative pursuant to sections 101(24), 1515(a), and 1509(b)(2) of the Bankruptcy Code. After undertaking an analysis of relevant case law and legislative history, the Fifth Circuit answered this question in the affirmative. Id. at *13-14.

3 A *concurso* is the Mexican analogue to a Chapter 11 plan of reorganization that, like a Chapter 11 plan, must be approved by an affirmative vote of a requisite number of creditors.

4 A majority of Circuits have concluded that equitable relief in the form of non-consensual third-party releases is authorized under the Bankruptcy Code. However, more recent decisions have narrowed such relief to extraordinary circumstances, sharply cutting back on more flexible standards pronounced in earlier decisions. Behrmann v. Nat'l Heritage Found., 663 F.3d 704 (4th Cir. 2011); In re Johns-Manville Corp., 600 F.3d 135 (2d Cir. 2010); Airadigm Commc'ns, Inc, v. FCC (In re Airadigm Commc'ns, Inc.), 519 F.3d 640, 656-57 (7th Cir. 2008); In re Dow Corning Corp., 280 F.3d 648, 658 (6th Cir. 2002); In re Drexel Burnham Lambert Group, Inc., 960 F.2d 285 (2d Cir. 1992).

A minority of Circuits, including the Fifth Circuit, have held that section 524(e) prohibits non-consensual third-party releases under all circumstances. Feld v. Zale Corp. (In re Zale Corp.), 62 F.3d 746, 760-61 (5th Cir. 1995); Resorts Int'l, Inc. v. Lowenschuss (In re Lowenschuss), 67 F.3d 1394, 1401-02 (9th Cir. 1995); Landsing Diversified Props.-II v. First Nat'l Bank & Trust Co. of Tulsa (In re Western Real Estate Fund), 922 F.2d 592, 601-02 (10th Cir. 1990), opinion modified, Abel v. West, 932 F.2d 898 (10th Cir. 1991).

Unlike the Circuits discussed above, the First Circuit has not directly ruled on the permissibility of non-consensual third-party releases. Nevertheless, in Monarch Life Ins. Co. v. Ropes & Gray, the First Circuit observed that in a situation where releases are necessary to protect parties contributing to the debtor's reorganization that would not contribute absent a release, "courts have afforded the 'incidental protection' of a permanent injunction by enjoining 'direct' actions *against the noncontributor* in order to protect the contributor from exposure to indirect liability." 65 F.3d 978, 980 (1st Cir. 1995) (emphasis in original).

Additionally, the Third Circuit has neither upheld nor rejected an absolute bar to all non-consensual third-party releases. Compare Gillman v. Continental Airlines (In re Continental Airlines), 203 F.3d 203, 214 (3d Cir. 2000), with In re Combustion Eng'g, Inc., 391 F.3d 190, 234 (3d Cir. 2004).

of international comity, including procedural due process considerations.[5] Vitro is a seminal development, as it creates an exacting framework for analyzing the enforceability of orders of foreign courts. It also is a controversial decision, as the Fifth Circuit's approach to statutory construction is arguably more conservative than the existing body of jurisprudence in the multilateral insolvency context, where recognition of foreign orders is more of a norm than the exception. It thus sets the stage for heated debate between the champions of "territorialism" and "internationalism" over the legitimacy of traditional approaches to statutory construction in the context of a statute derived from a Model Law that, in the most definitive of terms, essentially codifies legislative history, and decades of judicial experience, by announcing its stated purpose in its initial section, *i.e.*, to "provide effective mechanisms for dealing with cases of cross-border insolvency" by fostering cooperation and substantive assistance to parties involved in a foreign proceeding.[6]

The Fifth Circuit's parsing of Chapter 15 is logically appealing for practitioners seeking a systematic approach for evaluating whether foreign orders and decrees will gain recognition in Chapter 15 cases. Conversely, by declining to adopt a more holistic approach to Chapter 15 and the accommodative goals that animate it, the Fifth Circuit's mechanical application of Chapter 15 — at least in the unusual factual context of Vitro — may undermine cross-border restructurings, as the Fifth Circuit's opinion's interpretive rules tend to limit the ability of United States courts to recognize and enforce orders of foreign courts. If the Fifth Circuit's ruling commands support across sister-Circuits, the ultimate utility of Chapter 15 may be curtailed. Finally, broad United States adoption of the Vitro rationale may limit the ability of a foreign representative of a Chapter 11 case to obtain relief abroad. However, it remains to be seen how bankruptcy courts will apply the Fifth Circuit's holding to cases involving facts and orders more in line with the expectations of United States creditors.

II. BACKGROUND

A. Factual Background

Vitro S.A.B. de C.V. ("Vitro") is a holding company that, together with its subsidiaries, constitutes the largest glass manufacturer in Mexico. Between February 2003 and February 2007, Vitro borrowed a total of approximately $1.2 billion, predominantly from United States investors. Vitro's pre-LCM (as defined below) indebtedness was evidenced by three series of unsecured notes (collectively, the "Old Notes").[7] In February of 2009, Vitro announced its

---

[5] In the absence of Chapter 15, it may well have been the case that the releases would have been upheld under the doctrine of comity.

[6] 11 U.S.C. § 1501; see In re Elpida Memory, Inc., 2012 WL 5828748, at *5 (Bankr. D. Del. Nov. 16, 2012) ("[I]n Chapter 15 cases plain meaning should be subservient to legislative history or more general principles of comity."); see also 11 U.S.C. § 1508 ("In interpreting [Chapter 15], the court shall consider its international origin, and the need to promote an application of [Chapter 15] that is consistent with the application of similar statutes adopted by foreign jurisdictions.")

[7] Vitro Opinion at *1-2.

intention to restructure its debt and stopped making scheduled interest payments on the Old Notes. Payment in full of the Old Notes was guaranteed by substantially all of Vitro's subsidiaries (the "Guarantors").[8] The guaranties provide that the obligations of the Guarantors shall not be released, discharged, or otherwise affected by any settlement or release as a result of any insolvency, reorganization, or bankruptcy proceeding affecting Vitro.[9]

In late 2009, Vitro entered into a series of transactions for the purpose of restructuring its debt obligations, including its obligations under the Old Notes. These transactions included a sale leaseback with one of its largest third-party creditors.[10] As a result of these transactions, Vitro incurred approximately $1.5 billion of intercompany debt to its subsidiaries. Following these transactions, Vitro commenced a Mexican court proceeding under the Mexican Business Reorganization Act, or *Ley de Concursos Mercantiles* (the "LCM"). Shortly thereafter, Vitro's board of directors appointed a foreign representative, who commenced a Chapter 15 proceeding in the United States Bankruptcy Court for the Southern District of New York. Venue of the Chapter 15 case was later transferred on motion of certain creditors to the Northern District of Texas, the district in which Chapter 11 cases were pending for certain of Vitro's affiliates.

In late 2011, Vitro submitted a proposed restructuring plan (the "Concurso Plan") to the Mexican court.[11] The Concurso Plan provided, among other things, that (a) the Old Notes would be extinguished and the obligations owed by the Guarantors would be completely discharged and released, (b) Vitro would issue new notes with a total principal amount of $814,650,000, payable in 2019 (the "New 2019 Notes") to its third-party creditors but not to the subsidiaries holding intercompany debt, and the New 2019 Notes would be "unconditionally and supportively guaranteed for each of the Guarantors," (c) Vitro would provide to the holders of the Old Notes $95,840,000 in aggregate principal amount of new mandatory convertible debt obligations due in 2015, and (d) cash consideration of approximately $50 per $1,000 of principal of the Old Notes.[12]

After obtaining the requisite number of creditor votes under the LCM, which could not have been obtained without the votes of Vitro's non-debtor affiliates holding substantial intercompany claims, the Mexican court approved the Concurso Plan in February 2012. In March 2012, Vitro's foreign representative filed a motion (the "Enforcement Motion") with the United States Bankruptcy Court for the Northern District of Texas seeking recognition and enforcement of the Concurso Plan. The bankruptcy court denied the Enforcement Motion.

---

8 Id.

9 Id.

10 Under the terms of the sale leaseback, the creditor paid $75 million in exchange for the creation, in its favor, of a Mexican trust containing real estate contributed by Vitro's subsidiaries. The real estate was then leased to one of Vitro's subsidiaries to continue operations on the real property. Id. at *2.

11 Id. at *3.

12 The bankruptcy court's and Fifth Circuit's decisions shed little light on the percentage return on claims.

B. The Bankruptcy Court's Decision

In denying the Enforcement Motion, the bankruptcy court addressed two issues: (a) whether the plan's non-consensual third-party releases could be extended to creditors in the United States through sections 1521 or 1507 consistent with the principles of comity; and (b) if so, whether the exception in section 1506, which limits the reach of comity where it would be "manifestly contrary" to United States public policy, prevented enforcement of the order approving the Concurso Plan.[13]

Addressing the first issue, the bankruptcy court determined that section 1507 permits a bankruptcy court to provide additional assistance to a foreign representative if the factors enumerated in section 1507(b) are met.[14] The bankruptcy court concluded, however, that it could not provide "additional assistance" to the foreign representatives under section 1507 by recognizing the Mexican court's order confirming the Concurso Plan. The bankruptcy court held that the Concurso Plan did not provide for the distribution of proceeds of the debtor's property substantially in accordance with United States bankruptcy law, but instead provided "drastically different treatment in that the noteholders receive a fraction of the amounts owed under the indentures from Vitro and their rights against the other obligors are cut off."[15] The bankruptcy court also determined that the Concurso Plan did not meet the requirements of section 1521 because it did not sufficiently protect the interests of creditors in the United States or provide an appropriate balance between the interests of creditors and the debtor and its non-debtor subsidiaries.[16]

Although unnecessary after answering the first issue in the negative, the bankruptcy court nonetheless addressed the second issue and indicated that even if it were to find that section 1507's requirements were met, Vitro still could not overcome the public policy exception contained in section 1506.

---

[13] Vitro, S.A.B. de C.V. v. ACP Master, Ltd. (In re Vitro, S.A.B. de C.V.), 2012 Bankr. LEXIS 2682 at *8 (Bankr. N.D. Tex. June 13, 2012).

[14] Id. at *10.

[15] Id. at *40. Section 1507's mandate that distributions of the debtor's assets must be "substantially" in accordance with United States law derives from section 304, Chapter 15's predecessor. It appears that the Vitro courts were the first to address section 1507's substantial similarity requirement directly. However, courts applying section 304's analogue have denied relief under the "substantial" similarity doctrine where a creditor would have been secured under United States law but unsecured under foreign law. In re Toga Mfg. Ltd., 28 B.R. 165 (Bankr. E.D. Mich. 1983) (denying a Canadian trustee's motion to turnover an appellate bond on the grounds that the bond was security for a United States creditor's claim, and that granting the turnover request would lead to a distribution of the debtor's assets in a manner inconsistent with United States absolute priority).

[16] Vitro, S.A.B. de C.V. v. ACP Master, Ltd. (In re Vitro, S.A.B. de C.V.), 2012 Bankr. LEXIS 2682 at *40 (Bankr. N.D. Tex. June 13, 2012).

Analyzing the fairness of the Mexican judicial proceeding, the bankruptcy court determined that it could not conclude that the Mexican proceeding was unfair to the objecting parties.[17] Nevertheless, the bankruptcy court held that the language of section 524,[18] paired with Fifth Circuit case law, meant that the protection of third-party claims in a bankruptcy case is a fundamental policy of the United States, and that the plan, which seeks to extinguish such claims, "is manifestly contrary to such policy of the United States and cannot be enforced here."[19]

In short, the Vitro bankruptcy court followed its own Circuit's *per se* rule against non-consensual third-party releases and determined that the releases contained in the Concurso Plan were not consistent with United States public policy.[20] Departing from the weight of existing authority addressing non-consensual third-party releases, and at least one case addressing such releases under the public policy exception, the bankruptcy court opined that United States public policy is against the discharge of third-party claims in insolvency proceedings absent extraordinary circumstances, which were not present in this case.[21] The bankruptcy court noted that "[t]he Fifth Circuit has largely foreclosed non-consensual third-party releases and permanent injunctions outside of the context of mass tort claims being channeled toward a specific pool of assets."[22] It also considered and distinguished Metcalfe,[23] a bankruptcy decision from the Southern District of New York that recognized a foreign reorganization plan containing non-consensual third-party release and injunction provisions. In Metcalfe, the bankruptcy court explained, there was almost unanimous approval of the plan by the creditors (none of whom were insiders of the debtor), there was no timely objection to the order approving the plan, and the release was not complete like the one in the Concurso Plan.[24]

---

17 During the trial before the bankruptcy court and in arguments to the Fifth Circuit, the objecting parties argued that the Mexican judicial system was generally corrupt. At trial, the objectors presented expert witness testimony to this effect, but both the bankruptcy court and the Fifth Circuit did not credit that testimony. Id. at *37.

18 Section 524(e) provides that the "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." 11 U.S.C. § 524(e). Circuit Courts have reached different conclusions concerning the effect of section 524(e) on the ability of a bankruptcy court to approve non-consensual third-party releases. See supra note 4.

19 Vitro, S.A.B. de C.V. v. ACP Master, Ltd. (In re Vitro, S.A.B. de C.V.), 473 B.R. 117, 132 (Bankr. N.D. Tex. 2012).

20 Id.

21 Id. at 131.

22 Id.

23 In re Metcalfe & Mansfield Alt. Invs., 421 B.R. 685, 687 (Bankr. S.D.N.Y. 2010) (refusing to opine on whether the non-consensual third-party releases in question could have been obtained under United States law, and holding that "principles of enforcement of foreign judgments and comity in Chapter 15 cases strongly counsel approval of enforcement in the United States of the non-consensual third-party release and injunction provisions included in the Canadian Orders, even if those provisions could not be entered in a plenary chapter 11 case"). The Fifth Circuit agreed with the bankruptcy court that Metcalfe was distinguishable. Vitro Opinion at *22 n.32.

24 Vitro, S.A.B. de C.V. v. ACP Master, Ltd., 473 B.R. at 131-32.

III. THE FIFTH CIRCUIT'S DECISION

Vitro and the counterparty to the sale leaseback transaction appealed the bankruptcy court's decision directly to the Fifth Circuit. The only issue on appeal with respect to the enforcement of the Concurso Plan was "[w]hether the bankruptcy court erred as a matter of law when, after it concluded that the Concurso Approval Order was the product of a process that was not corrupt or unfair to the Appellees, it refused to enforce the Concurso Approval Order solely because the Concurso Plan novated guarantee obligations of non-debtor parties and replaced them with new obligations of substantially the same parties."[25]

In addressing this issue, the Fifth Circuit rejected the familiar comity-based approach generally utilized by United States bankruptcy courts in determining whether the enforcement of a foreign court's order was appropriate.[26] Instead, the Fifth Circuit developed a hierarchical approach of statutory interpretation. The Fifth Circuit first looked to sections containing more specific terms and then pronounced default rules governing the availability of more general provisions under which, in each case, recognition of a foreign court's order is to be analyzed. This three-step process applied by the Fifth Circuit is as follows:

1. First, a bankruptcy court must determine whether the relief requested by the foreign representative falls within the scope of the specific items enumerated in section 1521(a)(1)-(7).[27]

2. Second, if the relief requested is not specifically provided for in section 1521(a)(1)-(7), a bankruptcy court should decide whether it can be considered "appropriate relief" under the general terms of section 1521(a).[28]

3. Third, if the requested relief goes beyond the relief afforded under section 1521, a bankruptcy court then should consider whether "additional assistance" is appropriate under section 1507.[29]

Although not specifically identified as "steps" by the Fifth Circuit, there are two additional statutory considerations that logically follow from the Fifth Circuit's analysis. Namely, if the relief requested is authorized under step 1 or 2, a bankruptcy court must further determine whether granting the relief (a) sufficiently protects parties in interest under section 1522, and (b) is manifestly contrary to United States public policy under section 1506.

---

25 Vitro Opinion at *16.

26 See, e.g., In re Qimonda AG Bankr. Lit., 433 B.R. 547, 565 (E.D. Va. 2012) (holding that section 1509(b)(3) requires enforcement of a foreign court's order as long as the relief granted therein is not "manifestly contrary to the public policy of the United States"). However, the Qimonda decision has been criticized for misreading section 1509(b)(3) as requiring enforcement of foreign judgments provided they are not manifestly contrary to United States public policy. On its face, section 1509 is cabined to jurisdictional access to the United States judicial system. See infra note 58.

27 Vitro Opinion at *17.

28 Id.

29 Id. at *38.

Thus, according to the Fifth Circuit, upon or after recognition of a foreign main proceeding, a bankruptcy court may grant comity to a foreign court's order only if the relief: (a) (i) is provided for in section 1521 and permissible under section 1522, or (ii) is allowed under section 1507; and (b) is not manifestly contrary to United States public policy.[30]

A. Step 1 – Section 1521(a)(1)-(7)

The Fifth Circuit held that the relief requested — recognition of the Concurso Plan's non-consensual third-party releases — was not included in the relief enumerated in section 1521 of the Bankruptcy Code. Section 1521 lists certain specific relief that may be granted upon or subsequent to the recognition of a foreign proceeding. Relief that may be granted under this section includes (a) staying proceedings concerning the debtor's assets, (b) suspending the right to transfer, encumber, or otherwise dispose of any of the debtor's assets, (c) providing for the examination of witnesses and discovery, (d) entrusting the administration or realization of the debtor's assets to the foreign representative to preserve value where assets are perishable, susceptible to devaluation, or otherwise in jeopardy, and (e) granting any additional relief that may be granted to a Chapter 11 trustee, with the exception of avoidance powers.[31]

The Fifth Circuit analyzed section 1521(a)'s specific-relief provisions and held that the Concurso Plan's releases of the Guarantors could not be granted under that section. The Fifth Circuit paid particular attention to section 1521(a)(1), which provides for a stay of actions concerning the debtor's assets, and held that the permanent release contemplated by the Concurso Plan is not a "stay" under section 1521.[32] Moreover, the Fifth Circuit "rejected the bankruptcy court's suggestion to treat the assets of Vitro's subsidiaries as Vitro's 'assets' for this purpose."[33] Because Vitro's subsidiaries' assets were not considered Vitro's assets, the Fifth Circuit held that the releases of the Guarantors did not "concern" Vitro's assets for the purpose of section 1521(a)(1). Thus, without a specific statutory grant of authority, the Fifth Circuit next turned to whether the non-consensual third-party releases could be considered "appropriate relief" under section 1521(a).

B. Step 2 – Section 1521(a)'s Grant of "Any Appropriate Relief"

The Fifth Circuit also held that the third-party releases provided under the Concurso Plan fall outside the scope of section 1521(a)'s grant of judicial authority for two reasons. First, the Fifth Circuit held that the releases were inappropriate because Fifth Circuit case law explicitly forbids

---

30 CT Investment Management Co, LLC v. Cozumel Caribe, S.A. de C.V. (In re Cozumel Caribe, S.A. de C.V.), No. 10-13913, 2012 WL 5508303 (Bankr. S.D.N.Y. Nov. 14, 2012) (discussed further herein, and utilizing an analytical framework similar to the one developed by the Fifth Circuit, but in the more narrow context of a stay request).

31 See 11 U.S.C. § 1521(a)(1)-(7).

32 Vitro Opinion at *21.

33 Id.

a bankruptcy court from granting non-consensual third-party releases.[34] Second, the Fifth Circuit refused to approve the relief under section 1521(a) because the only other court to have examined the issue held that a non-consensual third-party release was proper "only in rare cases" and granted the relief pursuant to section 1507 rather than section 1521.[35]

According to the Fifth Circuit, "any appropriate relief" under section 1521(a) is limited to relief that previously was permissible under section 304 of the Bankruptcy Code or would otherwise be available under United States law.[36] Because the releases in question would not be available under United States law, the Fifth Circuit next examined whether the relief would be permissible under section 1507, which, according to the Fifth Circuit, "authorizes relief beyond that provided for in [the Bankruptcy Code] or United States law."[37]

Because the Fifth Circuit found no basis for enforcement of releases under United States law, it did not undertake a thorough analysis of section 1522's mandate that the interests of parties in interest be sufficiently protected, stating simply that "the facts of this case run afoul of the limitations in § 1522."[38] While few courts have analyzed section 1522's mandate, one court has described "sufficient protection" as "embodying three basic principles: 'the just treatment of all holders of claims against the bankruptcy estate, the protection of United States claimants against prejudice and inconvenience in the processing of claims in the [foreign] proceeding, and the distribution of proceeds of the [foreign] estate substantially in accordance with the order prescribed by U.S. law.'"[39]

C. Step 3 – Section 1507 and "Additional Assistance"

As steps 1 and 2 did not provide for the recognition and enforcement of a non-consensual third-party release, the Fifth Circuit turned to section 1507's "additional assistance" provision and held that the bankruptcy court properly denied the relief requested under section 1507. Under section 1507, a bankruptcy court may grant "additional assistance" to a foreign representative "[s]ubject to the specific limitations stated elsewhere in this chapter."[40] In determining whether to grant

---

34 Id. at *22 (citing In re Zale Corp., 62 F.3d 746, 760 (5th Cir. 1995) (holding that section 524 prohibits the discharge of non-debtors)).

35 Id. (citing In re Metcalfe & Mansfield Alt. Invs., 421 B.R. 685, 694 (Bankr. S.D.N.Y. 2010)).

36 Id. at *17.

37 Id. at *19 (citing In re Artimm S.r.L., 335 B.R. 149, 160 (Bankr. C.D. Cal. 2005). The proposition that section 1507 provides a bankruptcy court with the authority to grant relief beyond that which is available under United States law seemingly is at odds with the plain language of the statute, which provides that "[s]ubject to the specific limitations stated elsewhere in this chapter the court, if recognition is granted, may *provide additional assistance* to a foreign representative *under this title or under other laws of the United States*." 11 U.S.C. § 1507(a) (emphasis added).

38 Id. at *21.

39 In re Atlas Shipping A/S, 404 B.R. 726, 740 (Bankr. S.D.N.Y. 20009) (quoting In re Atrimm, S.r.L., 335 B.R. 149, 160 (Bankr. C.D. Cal. 2005)) (alterations in original).

40 11 U.S.C. § 1507(a).

additional assistance to the foreign representative, a bankruptcy court is required to consider whether the grant of additional assistance will "reasonably assure" (a) the "just treatment of all holders of claims against or interests in the debtor's property," (b) "protection of claim holders in the United States against prejudice and inconvenience in the processing of claims in such foreign proceeding," (c) "prevention of preferential or fraudulent dispositions of property of the debtor," (d) "distribution of proceeds of the debtor's property substantially in accordance with the order prescribed by this title," and (e) "if appropriate, the provision of an opportunity for a fresh start for the individual that such foreign proceeding concerns."[41]

The Fifth Circuit began its analysis of section 1507 by noting that there is "disagreement among the circuits as to when, if ever, a non-debtor discharge is appropriate," and that "although [the Fifth Circuit] has firmly pronounced its opposition to such releases, [such] relief is not thereby precluded under § 1507, which was intended to provide relief not otherwise available under the Bankruptcy Code or United States law."[42] In discussing whether the non-consensual third-party releases sought by Vitro were permissible under section 1507 generally, the Fifth Circuit concluded "that the evidence Vitro presented at trial does not support the presence of circumstances comparable to those necessary for effectuating the release of non-debtor guarantors in those of our sister circuits that allow such a release."[43] The Fifth Circuit noted that under the Concurso Plan (a) equity retained significant value, (b) the creditors did not receive a distribution close to what they were owed, and (c) the insider votes were crucial to its approval by creditors.[44]

The Fifth Circuit next addressed the core section 1507 issue: whether the bankruptcy court abused its discretion in holding that enforcement of the non-consensual third-party releases would be contrary to section 1507(b)(4), which provides that in granting additional assistance, a bankruptcy court must consider whether distribution of the debtor's property would be made substantially in accordance with the United States absolute priority rule.[45] The Fifth Circuit found that the release of the Guarantors "affects how the proceeds of Vitro's property are distributed."[46] Because the bankruptcy court did not abuse its discretion in holding that the releases in question extinguished (in the absence of extraordinary circumstances) the objecting

---

41 11 U.S.C. § 1507.

42 Vitro Opinion at *25.

43 Id. In reaching its conclusion regarding the scope of section 1507, the Fifth Circuit paid particular attention to the Metromedia decision. Id. at 46 (citing In re Metromedia Fiber Network, Inc., 416 F.3d 136, 141 (2d Cir. 2005) ("[a] nondebtor release in a plan of reorganization should not be approved absent the finding that truly unusual circumstances render the release terms important to success of the plan [such as whether] the estate received substantial consideration . . .; the enjoined claims were channeled to a settlement fund rather than extinguished . . .; the enjoined claims would indirectly impact the debtor's reorganization by way of indemnity or contribution . . . and the plan otherwise provided for the full payment of the enjoined claims . . . [or] the affected creditors consent[ed].")).

44 Id. at *30.

45 Id. at *27.

46 Id.

creditors' rights to collect against non-debtors, the Fifth Circuit held that the releases contravened section 1507(b) and could not be enforced in the United States.[47]

D. Step 4 – Manifestly Contrary to United States Public Policy

Having found no statutory basis for enforcing the releases under its hierarchical framework, the Fifth Circuit did not examine section 1506. However, the vast majority of courts discussing the public policy exception have indicated that it is to be narrowly construed against denial.[48] For example, the In re Ephedra Products Liability Litigation court affirmed a bankruptcy court decision recognizing and enforcing a Canadian claims process that did not provide personal injury claimants with the right to a jury trial.[49] The mere fact that application of United States law and foreign law yield different results is not enough to trigger section 1506's public policy exception. Rather, the inquiry focuses on two factors: "(i) whether the foreign proceeding was procedurally unfair, and (ii) whether the application of foreign law or the recognition of a foreign main proceeding under Chapter 15 would severely impinge the value and import of a United States statutory or constitutional right, such that granting comity would severely hinder U.S. bankruptcy courts' abilities to carry out . . . the most fundamental policies and purposes of these rights."[50]

Had the Fifth Circuit found a statutory basis for enforcing the releases, it likely would have been compelled to reverse the decision of the bankruptcy court based on section 1506 and related precedent. First, there was no finding that the Mexican proceeding was procedurally unfair. As stated by the Fifth Circuit, "[t]he bankruptcy court . . . concluded that it 'ha[d] not seen evidence that the Mexican Proceeding [was] the product of corruption, or that the LCM itself is a corrupt process.'"[51] Moreover, the Fifth Circuit appeared to discount what has been an important factor in other bankruptcy court recognition decisions, namely, the fact that creditors had the opportunity to object, and did object, to the proposed reorganization plan in the foreign court.[52] Second, in neither of the Vitro decisions does any court hold that the prohibition against non-consensual third-party releases severely hinders the value of a United States constitutional or statutory right.

---

47 Id. at *30.

48 See Ackermann v. Levine, 788 F.2d 830 (2d Cir. 1986) (recognizing the "narrowness of the public policy exception to enforcement [of foreign judgments]" and noting "[a]s Justice Cardozo so lucidly observed: 'We are not so provincial to say that every solution to a problem is wrong because we deal with it otherwise at home.'").

49 In re Ephedra Prods. Liability Litig., 349 B.R. 333, 335 (S.D.N.Y. 2006).

50 In re Qimonda AG, 462 B.R. 165 (Bankr. E.D. Va. 2011).

51 Vitro Opinion at *15.

52 Id. at *28 n.41.

IV. PRACTICAL IMPLICATIONS

The Vitro decision's strict reliance on principles of statutory construction (untempered by the broad policy objectives in sections 1501 and 1508) could lead to an erosion of the fundamental purpose of Chapter 15 if future bankruptcy courts give greater weight to United States substantive laws, at the expense of comity, in determining the relative comparability of foreign and United States laws in the cascading analysis called for under the hierarchical approach. As stated by the Delaware bankruptcy court in Elpida, "in Chapter 15 cases plain meaning should be subservient to legislative history or more general principles of comity."[53] In support of this position, it should be noted that Congress replaced section 304 of the Bankruptcy Code with Chapter 15 in 2005, due in large part to the fact that section 304 minimized the importance of comity by listing it as one of six factors used by a bankruptcy court to determine whether a foreign insolvency proceeding warranted deference and assistance.[54] Section 1501(a) codified the five principal objectives of Chapter 15, each of which is an expression of the comity principle.[55] Moreover, through the enactment of section 1508, Congress instructed bankruptcy courts to consider Chapter 15's "international origin, and the need to promote an application of this chapter that is consistent with the application of similar statutes adopted by foreign jurisdictions."[56]

While United States law may not have permitted a non-consensual third-party release under the same facts and circumstances as the Concurso Plan, Mexican law does and did permit releases of that nature. The Fifth Circuit even stated in Vitro that "[i]n considering whether to grant relief, it is not necessary that the result achieved in the foreign bankruptcy proceeding be identical to that

---

53 In re Elpida Memory, Inc., 2012 WL 5828748, at *5 (Bankr. D. Del. Nov. 16, 2012).

54 The judicial determination to grant or withhold relief in a case ancillary to a foreign proceeding was subject to a single guiding standard, *i.e.*, what will best assure an economical and expeditious administration of the estate. In reaching that determination, bankruptcy courts were directed to weigh and evaluate six factors: (a) just treatment of all holders of claims, (b) protection of United States claim holders against prejudice and inconvenience, (c) prevention of fraudulent dispositions of property, (d) distribution in substantial accordance with the United States Bankruptcy Code, (e) the opportunity for a fresh start for the debtor, and (f) comity. 11 U.S.C. § 304(c). See In re Papeleras Reunidas S.A., 92 B.R. 584, 594 (Bankr. E.D.N.Y. 1988) (seemingly downplaying the importance of comity by giving it weight equal to many other factors used to determine whether to enforce an order of a foreign bankruptcy court).

55 The purposes of Chapter 15 are as follows: "(1) to promote cooperation between the United States courts and parties in interest and the courts and other competent authorities of foreign countries involved in cross-border insolvency cases; (2) to establish greater legal certainty for trade and investment; (3) to provide for the fair and efficient administration of cross-border insolvencies that protects the interests of all creditors and other interested entities, including the debtor; (4) to afford protection and maximization of the value of the debtor's assets; and (5) to facilitate the rescue of financially troubled businesses, thereby protecting investment and preserving employment." 11 U.S.C. § 1501(a).

56 11 U.S.C. § 1508. Adding to the uncertainty surrounding Vitro's reorganization, the bankruptcy court issued a memorandum opinion on December 4, 2012 considering and approving involuntary Chapter 11 petitions filed against the Guarantors. In re Vitro Asset Corp., Case No. 11-32600 (Bankr. N.D. Tex. Dec. 4, 2012).

which would be had in the United States[,] [i]t is sufficient if the result is comparable."[57] It is clear that the relief granted by the Mexican court was "comparable" to the relief available under United States law, even if the facts and circumstances underlying the relief would not necessarily suffice in a Chapter 11 case, let alone under a "Circuit-centric" analysis. Moreover, assuming Chapter 15 were never enacted, it is arguable that the non-consensual third-party releases at issue in Vitro would have been approved under centuries-old comity principles, which focus on whether the foreign proceeding is procedurally fair and whether the relief requested is repugnant to United States public policy.[58] Were non-consensual third-party releases truly repugnant as a matter of United States public policy, they would have no place in the American bankruptcy system — yet they are permitted in the majority of Circuit Courts, albeit under limited circumstances.

Ultimately, if strictly followed by other courts, the Vitro decision puts a new burden on foreign representatives to make affirmative showings previously not required by Chapter 15 jurisprudence, and opens the door to a host of objections by creditors who are displeased with the result in the foreign court. [59] Thus, it remains to be seen how similar the relief requested by a foreign representative must be with relief available under United States law to pass muster under section 1521. For example, there may be instances where a foreign court's sale order provides for a sale "free and clear" of certain claims or interests that would continue to encumber the property under "applicable non-bankruptcy law" within the meaning of section 363(f)(1) (assuming no other 363(f) subsection affords the debtor the authority to sell the property "free and clear"). In such a case, the Vitro decision seems to direct a bankruptcy court to deny enforcement of the sale under United States law, without regard to whether foreign law, and the foreign court, properly permitted the sale free and clear of such claim or interest. This potentially allows a foreign creditor a chance to have a bankruptcy court act as a super-appellate

---

57 Vitro Opinion at *8 (internal citations and quotations omitted).

58 Although articulated in the context of enforcing foreign law, American courts have adopted the same rule for the enforcement of foreign judgments, which will generally be enforced "except in situations where the original claim is repugnant to fundamental notions of what is decent and just in the State where enforcement is sought." RESTATEMENT (SECOND) OF CONFLICTS § 117, cmt. c.

59 CT Investment Management Co, LLC v. Cozumel Caribe, S.A. de C.V., 2012 WL 5508303 at *10. It is possible that the Vitro framework already has gained traction in the Southern District of New York. In a recent decision from that bankruptcy court, Judge Glenn criticized the Qimonda case by stating that "[g]ranting comity to a foreign representative by providing access to courts in the United States is very different from granting the request by the foreign representative to extend comity to a foreign law, court order or judgment." As such, the bankruptcy court stated that other cases (including Qimonda), holding that extending comity to foreign laws or court orders is required as long as that relief is not "manifestly contrary to the public policy of the United States," are wrong. Id. at *10-11. In holding that the injunction requested by the foreign representative was permissible under section 1521, the court adopted a hierarchical approach similar to the Vitro analysis by stating that "[b]ecause section 1521 would permit the relief sought by the Foreign Representative, it is unnecessary to look to section 1507 for such authority." Id. at *11.

court (exercising *de novo* review) for a foreign sale, even if the procedures employed by the foreign court were fair.[60]

It is also possible to envision a "boomerang" effect resulting from the Fifth Circuit's constrictive interpretation of Chapter 15. One obvious example arises under section 502(b)(6) of the Bankruptcy Code, which provides that a landlord's rejection damages are capped at the greater of the rent reserved by the rejected lease for one year, or, for 15% of the remainder of the lease, not to exceed three years.[61] This allows a Chapter 11 debtor to limit the damages arising from its rejection, under a rejection order or a confirmation order providing for rejection, of a non-residential real property lease. If the debtor is a multinational corporation and the rejected leasehold is located in a foreign jurisdiction, the foreign representative will need to seek the assistance of the foreign court in effectuating the terms of the lease rejection. In a post-Vitro world, it is conceivable that a foreign court would refuse, under its Chapter 15 analogue,[62] to recognize and enforce the United States court's confirmation order on the grounds that the landlord is receiving less under the Chapter 11 plan that it would be entitled to under the foreign law, regardless of whether the imposed damages cap is manifestly contrary to the foreign country's public policy or the Chapter 11 proceeding afforded the landlord adequate due process protections.

In applying the Vitro framework, bankruptcy courts must be careful to give sufficient weight to Chapter 15's international origins and codified purposes (which rest on the principle of comity) to ensure that the purposes of Chapter 15 are not subsumed in the peculiarities and nuances of United States bankruptcy jurisprudence. It remains to be seen how bankruptcy courts will apply the Fifth Circuit's hierarchical framework to facts and orders more in line with United States creditors' expectations. However, absent sufficient consideration of Chapter 15's core principles, there is a substantial risk that Chapter 15 will impair a foreign debtor's efforts to obtain a United States court's assistance and cooperation in the administration of a procedurally fair foreign insolvency case, as well as negatively influence a foreign court's determination of whether to grant relief requested by a foreign representative of a Chapter 11 case.

---

60 Similar issues will be litigated soon in the Elpida case. In that case, the foreign representative of the debtor's Japanese main proceeding will seek bankruptcy court approval of a sale of the debtor's assets to a third party. A group of bondholders have already indicated that they believe the sale price is inadequate and in violation of the United States business judgment standard. Moreover, the bankruptcy court stated in a recent decision that it "must . . . review the [sale] motion *de novo* as it relates to assets in the United States and, in so doing, must apply the well-settled standards governing a sale of assets under section 363 of the Bankruptcy Code." Elpida Memory Inc., at *9.

61 11 U.S.C. § 502(b)(6).

62 Chapter 15 was developed from the United Nations Commission on International Trade Law's Model Law on Cross-Border Insolvency. To date, 20 countries have adopted some form of the Model Law.

* * * * * * * * * * * * * * *

If you have any questions regarding this memorandum, please contact Marc Abrams (212-728-8200, mabrams@willkie.com), Mary K. Warren (212-728-8205, mwarren@willkie.com), Alex W. Cannon (212-728-8899, acannon@willkie.com) or the Willkie attorney with whom you regularly work.

Willkie Farr & Gallagher LLP is headquartered at 787 Seventh Avenue, New York, NY 10019-6099. Our telephone number is (212) 728-8000 and our facsimile number is (212) 728-8111. Our website is located at www.willkie.com.

December 7, 2012

Copyright © 2012 Willkie Farr & Gallagher LLP.

All Rights Reserved. This memorandum may not be reproduced or disseminated in any form without the express permission of Willkie Farr & Gallagher LLP. This memorandum is provided for news and information purposes only and does not constitute legal advice or an invitation to an attorney-client relationship. While every effort has been made to ensure the accuracy of the information contained herein, Willkie Farr & Gallagher LLP does not guarantee such accuracy and cannot be held liable for any errors in or any reliance upon this information. Under New York's Code of Professional Responsibility, this material may constitute attorney advertising. Prior results do not guarantee a similar outcome.