Consensual Deal Ends Restructuring of Vitro S.A.B., de C.V.; Predicting its Potential Impact Begins

The dueling judicial decisions in Mexico and the United States regarding the proposed restructuring of the Mexican enterprise, Vitro S.A.B., de C.V., and its affiliates (collectively, "Vitro"), and its strong opposition by a group of U.S. noteholders, became must-read thrillers for finance and bankruptcy professionals, as well as distressed-debt investors. While a recently announced settlement among the parties appears to have closed the book on this highly publicized restructuring, the various court rulings could have a significant impact on future cross-border restructurings and the willingness of U.S. and other investors to fund foreign companies.

Factual Background

Vitro's Mexican Restructuring and Insolvency Proceedings

Vitro is the largest glass manufacturer in Mexico. In early 2009, Vitro defaulted on three series of bonds, among other things, and by 2011, owed more than $1.8 billion to various creditors.[1]

Anticipating insolvency proceedings, Vitro, in coordination with friendly investor Fintech Investment Ltd. ("Fintech"), engaged in a series of transactions that turned $1.2 billion that its subsidiaries owed to it into $1.5 billion in inter-company debt that it owed to its subsidiaries. At the same time, Fintech purchased interests in certain real estate assets for $75 million and leased them back to Vitro, with Fintech being granted the right to exchange its interests in such assets for 24% of a restructured Vitro.

After the expiration of the 270-day look-back avoidance period under Mexican law, Vitro commenced insolvency proceedings in Mexico. Vitro then proposed a restructuring plan that provided for new notes and some cash to be exchanged for old notes and extinguished related prior obligations, including those of non-debtor guarantors, while the existing shareholders preserved significant equity interests in Vitro.[2]

Under Mexican insolvency law, an affirmative vote of only a simple majority of creditors by dollar amount of claims (*i.e.*, a 50+% majority) is required for a class of claims to be deemed to accept a Mexican restructuring plan, as opposed to the more than two-thirds in dollar amount required under U.S. law (along with a majority in number). In addition, under Mexican law, there is no restriction on counting claims held by insiders in connection with plan voting, like those that may apply in a U.S. bankruptcy proceeding. Notwithstanding the negative votes of at least $1.2 billion in notes held by objecting holders, the unsecured creditor class as a whole voted to accept the plan, including the affirmative votes by the subsidiaries on their inter-company claims and Fintech. Had such insider votes not been considered, the plan would not have obtained the majority required by Mexican law.

Ultimately, this restructuring plan was approved by the Mexican court administering Vitro's insolvency proceedings over the noteholders' objections, and lawsuits in the U.S. ensued.[3]

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1 *Ad Hoc Group of Vitro Noteholders* v. *Vitro SAB De CV (In re Vitro SAB De CV)*, 701 F.3d 1031, 1036 (5th Cir. 2012).

2 701 F.3d at 1036-38.

3 *Id.* at 1039.

U.S. Bankruptcy Proceedings

In connection with the Mexican restructuring plan, Vitro commenced an associated case under Chapter 15 of the U.S. Bankruptcy Code. The case was originally filed in the U.S. Bankruptcy Court for the Southern District of New York, but it was transferred to the U.S. Bankruptcy Court for the Northern District of Texas. Vitro's Chapter 15 foreign representative filed a motion in the Texas Bankruptcy Court to enforce the Mexican restructuring plan, including to enjoin all actions pending against Vitro (including its non-debtor subsidiary guarantors that had been sued in U.S. courts but were purportedly released under the Mexican restructuring plan); to declare all previously rendered judgments against Vitro null and void; and to release Vitro from all liabilities associated with claims discharged under the Mexican restructuring plan.[4] Certain noteholders filed an objection to this requested relief and argued, among other things, that the prior order of the Mexican court approving the Mexican restructuring plan should not be accorded comity in the U.S. because it ran afoul of Bankruptcy Code §1506[5] in that it was "manifestly contrary" to public policy.[6]

The Bankruptcy Court agreed with these noteholders and declined to recognize the Mexican restructuring plan or to enforce the order approving it because (1) under that plan, the "noteholders receive a fraction of the amounts owed [them] ... and their rights against the [non-debtor] obligors are cut off", which would be contrary to Bankruptcy Code § 1507(b)(4),[7] and (2) the plan "neither sufficiently protects the interests of creditors in the U.S., nor does it provide an appropriate balance between the interests of creditors and Vitro ...", which the court concluded was not consistent with Bankruptcy Code §§ 1521(b) (interests of creditors not sufficiently protected)[8] and 1522(a) (similar).[9] The Bankruptcy Court similarly held that the protection of third-party claims is a "fundamental policy of the U.S.", and the Mexican plan, which did not protect such rights against the guarantors, for example, was manifestly contrary to that policy for that reason as well.[10]

Appeal to U.S. Court of Appeals for the Fifth Circuit

Vitro's foreign representative and Fintech each appealed this ruling, which was certified for direct appeal to the U.S. Court of Appeals for the Fifth Circuit. Applying an abuse of discretion standard and strictly interpreting the applicable statutory provisions, the Court of Appeals affirmed the Bankruptcy Court's decision on two grounds.[11] Specifically, the court held that (1) the relief sought by Vitro to "discharge[] obligations held by

4 *See In re Vitro, S.A.B, de C.V.*, 473 B.R. 117, 119 (Bankr. N.D. Tex. 2012).

5 Section 1506, entitled "Public policy exception", provides that "Nothing in this chapter [15] prevents the court from refusing to take an action governed by this chapter if the action would be manifestly contrary to the public policy of the United States."

6 473 B.R. at 121.

7 Section 1507(b)(4) states that, "[i]n determining whether to provide additional assistance" to a foreign representative, "the court shall consider whether such additional assistance, consistent with the principles of comity, will reasonably assure… distribution of proceeds of the debtor's property substantially in accordance with the order proscribed by" the Bankruptcy Code.

8 Section 1521(b) states that certain relief may be granted upon recognition of a foreign proceeding "provided that the court is satisfied that the interests of creditors in the United States are sufficiently protected."

9 473 B.R. at 132. Section 1522(a) states that certain relief may be granted, modified, or terminated "only if the interests of the creditors and other interested entities, including the debtor, are sufficiently protected."

10 The Bankruptcy Court also identified, but did not thoroughly evaluate, other "possible meritorious objections" to recognition, including that inter-company creditors were permitted to vote their debt to approve the Mexican restructuring plan. 473 B.R. at 132.

11 701 F.3d at 1060-61.

non-debtor guarantors" was not available under Bankruptcy Code § 1521, and (2) Vitro failed to demonstrate "extraordinary circumstances" to permit granting the requested relief under Bankruptcy Code § 1507.[12]

The Court of Appeals first considered the role of Bankruptcy Code § 1521, which permits a Bankruptcy Court to "'grant any appropriate relief' when necessary to 'effectuate the purpose of [Chapter 15] and to protect the assets of the debtor or the interests of the creditors.'"[13] The court recognized that Bankruptcy Code § 1522 expressly limits relief available under Section 1521 where "the interests of the creditors ... are [not] sufficiently protected."[14] The court then concluded that recognition of the Mexican restructuring plan was not appropriate because doing so was not the type of relief enumerated in Section 1521(a) or (b), and also because such relief was contrary to, and prohibited by, the Bankruptcy Code, because the only non-debtor discharge ever approved by a U.S. court in a foreign proceeding was authorized under Bankruptcy Code § 1507, not Section 1521.[15]

The court next considered the impact of Bankruptcy Code § 1507, which enables bankruptcy courts to provide "additional assistance" to a debtor, if doing so would be "consistent with the principles of comity" and would "reasonably assure", among other things, the "distribution of proceeds of the debtor's property substantially in accordance with" the Bankruptcy Code, on the issue.[16] Recognizing that non-debtor discharges had been granted only in rare circumstances, including more frequently in Mexico than in the U.S., the court concluded that such relief was "theoretically available" under Section 1507,[17] and even though it observed that "comity is the rule under Chapter 15, not the exception", and that comity would not be offended by enforcing the Mexican restructuring plan because other courts had deferred certain similar issues to be decided by Mexican courts,[18] the court nonetheless concluded that the evidence presented by Vitro failed to demonstrate that "extraordinary circumstances" warranted the relief requested and, as a result, such relief was inappropriate.[19] In reaching this conclusion, the court emphasized that "equity retained substantial value" to the detriment of debtholders, which runs contrary to the absolute-priority rule of the Bankruptcy Code and many other key tenets of U.S. bankruptcy law.[20]

The consequence of this decision, in which the court expressly rejected Vitro's argument that the Mexican restructuring plan should be enforced because it was approved by a majority of Vitro's creditors and that "financial chaos" would ensue if it were not enforced, was that the Mexican restructuring plan could not be enforced in the U.S. under Chapter 15, and the noteholders (whose claims against the non-debtor subsidiary guarantors were purported to be eliminated by the Mexican restructuring plan), therefore, were permitted to pursue the guarantors.[21]

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12 *Id*.

13 *Id.* at 1055 (*quoting* 11 U.S.C. § 1521(a)).

14 *Id.*

15 *Id.* at 1059-60.

16 *Id.* at 1060.

17 *Id.* at 1062.

18 *Id.* at 1064 (citing *Wilmington Trust* v. *Vitro Automotriz, S.A. de C.V.*, 943 N.Y.S.2d 795 (N.Y. Sup. Ct. 2011)).

19 *Id*. at 1067.

20 *Id.*

21 The noteholders similarly prevailed in suits to enforce the guaranties against the subsidiary guarantors. *See ACP Master, Ltd.* v. *Vitro S.A.B. de C.V.*, 941 N.Y.S. 2d 536 (N.Y. Sup. Ct. 2011) *aff'd*, 945 N.Y.S. 2d 1 (N.Y. App. 2012) (granting noteholders' motion for summary judgment); *Wilmington Trust* v. *Vitro Automotriz, S.A. de C.V.,* 943 N.Y.S.2d 795 (N.Y. Sup. Ct. 2011) (granting motion for declaratory judgment that guaranties are enforceable).

Settlement and Conclusion

Following the Court of Appeals decision, the future of Vitro was uncertain, until recently, when it was reported that the various parties came to terms on a consensual restructuring. Pursuant to this resolution, which would settle outstanding disputes with Vitro's objecting noteholders, Fintech would purchase $1.2 billion in notes held by such noteholders for an undisclosed amount, presumably significantly more than the consideration proposed to be provided to such holders under Vitro's original restructuring plan.

The impact of the Vitro restructuring and litigation saga on U.S. and potential Mexican insolvency practice, and cross-border insolvency practice in general, however, does not necessarily end with this settlement. As a result of the litigation, it is now somewhat more clear what is required for a U.S. bankruptcy court to recognize a foreign judgment under Chapter 15. Despite the general policy of favoring international comity that drove the promulgation of Chapter 15 and related statutes around the world, it appears that U.S. courts may deny recognition of foreign rulings that offend established U.S. bankruptcy (and perhaps other) policies. It is less clear which of those policies might be considered sacrosanct and under what circumstances and how this shift in approach by a U.S. court might affect the way U.S. court rulings are treated in foreign insolvency proceedings, to the potential detriment of U.S. creditors and/or companies.

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If you have any questions about the issues addressed in this memorandum or if you would like a copy of any of the materials mentioned, please do not hesitate to call or email Joel H. Levitin at 212.701.3770 or jlevitin@cahill.com; Richard A. Stieglitz Jr. at 212.701.3393 or rstieglitz@cahill.com; or Daniel R. LeCours at 212.701.3037 or dlecours@cahill.com.