Jurisdictional Mix-and-Match: *Vitro*, *Elpida* and *Fairfield* Demonstrate the Uncertainties of Cross-Border Bankruptcy for US Bondholders and Buyers

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Seasoned participants in the world of cross-border insolvency recognize the inherent complications when US and non-US insolvency laws must be reconciled—for example, when a non-US entity faces the need to restructure debt issued under US law that is held primarily by US-based investors, or when a foreign debtor seeking relief from US debts in a cross-border insolvency seeks approval from a US court to sell its assets.

Under chapter 15 of the US Bankruptcy Code, there is no clearly defined standard for when a US court should extend the effect of a foreign court order to the US, and when it should decline to do so. Recent decisions from the US Court of Appeals for the Fifth Circuit, the US Bankruptcy Court for the District of Delaware, and the US Bankruptcy Court for the Southern District of New York demonstrate that these issues are continuing to develop as cross-border cases become more prevalent and as chapter 15 jurisprudence comes of age.

***Vitro*: When Should US Courts Enforce Foreign-Law Discharges of Non-Debtor Subsidiaries?**

In *Ad Hoc Group of Vitro Noteholders v. Vitro SAB de CV*, 701 F.3d 1031 (5th Cir. 2012), the US Court of Appeals for the Fifth Circuit decided that non-consensual discharges of the debtor's non-debtor affiliates, approved by a foreign court in a foreign main insolvency proceeding, should not be enforced in a US chapter 15 case.

Vitro SAB de CV is a Mexican holding company that, together with its subsidiaries, is the largest glass manufacturer in Mexico. Towards the end of the last decade, Vitro had difficulties paying its debts and attempted to restructure its notes. In 2010, Vitro disclosed that it would attempt to file for reorganization under Mexican law (the *Ley de Concursos Mercantiles* or "*Concurso*") with a partially pre-arranged plan. While Vitro's first three plans were rejected by creditors, its final plan, filed on January 7, 2011, was accepted. However, Vitro could not have received approval of its plan without the votes of its non-debtor subsidiaries, which held over 50% of the voting claims in the form of intercompany debt. That fact pattern caused the Mexican lower court to deny confirmation of the

Concurso plan notwithstanding the favorable vote, but the lower court's ruling was overturned on appeal, and the *Concurso* plan was ultimately approved.

Vitro's approved *Concurso* plan provided that three series of US-issued unsecured notes would be extinguished and the obligations owed by the guarantors of those notes would be discharged. Substantially all of Vitro's subsidiaries guaranteed the unsecured notes, but those guarantors were not debtors in the *Concurso* proceeding.

The *Concurso* plan was confirmed in Mexico in February 2012. In March 2012, Vitro's foreign representatives, who had commenced a chapter 15 proceeding in the US, sought to give full force and effect in the United States to the Mexican court's order approving the *Concurso* plan, and to obtain a permanent injunction prohibiting certain actions in the United States against Vitro and its non-debtor subsidiaries.

The US Bankruptcy Court for the Northern District of Texas, where Vitro's chapter 15 case is pending, denied the foreign representatives' request in response to objections by Vitro's bondholders. The foreign representatives were granted a direct appeal to the US Court of Appeals for the Fifth Circuit.

While the Fifth Circuit's analysis dives deeply into the statutory framework of chapter 15 and provides helpful guidance on the distinctions between relief available under section 1507 of the Bankruptcy Code (allowing the court to grant "additional assistance" to a foreign representative, consistent with the principles of comity) as contrasted with section 1521 of the Bankruptcy Code (allowing the court to grant "appropriate relief" to a foreign representative), the central issue to be decided by the Fifth Circuit was one of comity. The Fifth Circuit considered whether a US court in a chapter 15 case should enter a discharge injunction, based on a foreign court's judgment, to protect foreign non-debtors from enforcement of US-issued debts, guaranteed by the non-debtors, owed to US investors. The Fifth Circuit also considered the corollary question of whether it mattered that such non-debtor discharges would be unavailable in a US chapter 11 proceeding.

The Fifth Circuit affirmed the ruling of the bankruptcy court in Vitro and denied the request for a non-debtor discharge injunction in the US, effectively refusing to extend the effect of the Mexican court's judgment to creditors in the US. The Fifth Circuit held that a non-debtor discharge injunction is not an available form of relief under section 1521 of the Bankruptcy Code. The Fifth Circuit also held that although a court may theoretically honor a non-debtor discharge injunction under section 1507 of the Bankruptcy Code, Vitro's foreign representatives had failed to establish the extraordinary circumstances necessary to justify the grant of such relief.

In reaching its decision, the Fifth Circuit distinguished the circumstances before it from the extraordinary circumstances that led the US Bankruptcy Court for the Southern District of New York to approve non-debtor releases in an earlier chapter 15 case, *In re Metcalfe & Mansfield Alternative Investments*, 421 B.R. 685 (Bankr. S.D.N.Y. 2010). As in Vitro's Mexican insolvency proceeding, the non-debtor releases in *Metcalfe* had been approved in the parent entity's main insolvency proceeding in its home jurisdiction of Canada. However, in *Metcalfe*, unlike in *Vitro*, the Canadian plan had been approved nearly unanimously by Metcalfe's non-insider creditors and without objection. Further, the failure to respect the non-debtor discharge injunction in *Metcalfe* was considered to have potentially substantial effects on the entire Canadian commercial paper market, not just the parties immediately involved in the case.[1]

Elpida: When Should US Courts Approve Sales of US Assets Authorized in Foreign Insolvency Cases?

In the chapter 15 case of *Elpida Memory, Inc.*, the US Bankruptcy Court for the District of Delaware decided that it could hear a challenge, under the standards of section 363(b) of the US Bankruptcy Code, to a sale of US assets that was previously approved by the Japanese court presiding over Elpida's main insolvency proceeding. *In re Elpida Memory, Inc.*, Case No. 12-10947 (CSS), 2012 WL 6090194 (Nov. 20, 2012). But, after hearing that challenge, the Delaware bankruptcy court approved the sale of the US assets in an order dated January 16, 2013.

Elpida had commenced its Japanese insolvency proceeding in February 2012 and commenced an ancillary chapter 15 case in the US Bankruptcy Court for the District of Delaware the following month. After the commencement of these cases, *Elpida* sought and obtained approval from the Japanese court for transactions involving the disposition of certain Elpida assets, including assets located in the US. In September 2012, months after the consummation of the asset dispositions and in response to concerns expressed by certain of Elpida's bondholders, *Elpida* sought retroactive approval of the transactions in its US chapter 15 case.

Elpida argued that the Delaware bankruptcy court need only inquire whether comity should be granted to the Japanese court's approval of the transactions—that is, whether the Japanese insolvency process affords parties basic due process rights such that the Japanese court's decisions should be enforced in the US. Elpida's US bondholders argued to the contrary—that dispositions of US assets outside the ordinary course of business should be reviewed under the standards of US Bankruptcy Code section 363(b), even if those dispositions were previously approved in Japan. In its November 2012 decision, the Delaware bankruptcy court agreed with the bondholders and required the dispositions to adhere to section 363(b) standards of sound business judgment, fair price, adequate notice, and good faith.[2] In its January 2013 decision, the Delaware court found that those section 363(b) standards had been satisfied and approved the asset dispositions. On January 30, 2013, the US bondholders filed a motion for reconsideration of the court's order approving the sale.

Fairfield: When Should US Courts Decline to Review Sales of Assets Authorized in Foreign Insolvency Cases?

In some respects, the decision of a New York bankruptcy court in the Fairfield case is the opposite of the decisions of the Delaware bankruptcy court in the *Elpida* case.

In *In re Fairfield Sentry Limited*, No. 10-13164 (BRL), 2013 WL 139185 (Bankr. S.D.N.Y. Jan. 10, 2013), the US Bankruptcy Court for the Southern District of New York declined to review, under section 363 of the US Bankruptcy Code, the decision of a British Virgin Islands (BVI) court approving a sale of a debtor's assets, because the sale did not involve any US property and did not implicate sufficient interests of the US to warrant refusing comity to the BVI court's decision.

The debtor in *Fairfield*, Fairfield Sentry Limited, was a large feeder fund for investors in Bernard L. Madoff Investment Securities (BLMIS). In the wake of BLMIS' fall, Fairfield was placed into a liquidation proceeding in the BVI, and its foreign representative commenced a chapter 15 proceeding in the US. Fairfield filed customer claims in BLMIS' US Securities Investor Protection Act (SIPA) liquidation proceeding. The trustee for BLMIS' SIPA liquidation filed suit against Fairfield, seeking to recover alleged fraudulent transfers and disallow Fairfield's claims. Fairfield and the BLMIS trustee settled the lawsuit and agreed that Fairfield would have an allowed SIPA claim of $230 million against BLMIS.

In 2010, Fairfield's foreign representative conducted an auction to sell the SIPA claim against BLMIS. At the conclusion of that process, the foreign representative agreed to sell the claim for about a third of its allowed amount to the highest bidder, a large US hedge fund. The sale documentation required that both the BVI court and the US bankruptcy court in Fairfield's chapter 15 proceeding approve the assignment of the claim. Just days after the sale documents were finalized (but before they were submitted to any court for approval), the price at which SIPA claims against BLMIS were trading skyrocketed due to a settlement reached by the BLMIS trustee. After the Fairfield foreign representative failed to seek the BVI court's approval of the sale, the purchaser filed an application seeking to compel the foreign representative to seek court approval and consummate the sale. The BVI court held a hearing and concluded that the sale documents were valid and approval was warranted as a matter of BVI law. The BVI court deferred any rulings on US bankruptcy law issues to the US bankruptcy court, effectively placing the decision of whether the sale would move ahead in the hands of the US bankruptcy court.

The foreign representative urged the US bankruptcy court to apply the standards for approval of a sale under section 363 of the US Bankruptcy Code, and accordingly to conduct a review of whether the sale was in the "best interests of the estate." The foreign representative's position was likely informed by the fact that if the pending sale were not approved, the estate could make a substantial profit by walking away from the pending sale and selling the claim to a new buyer at the increased market price.

However, the New York bankruptcy court concluded that no such review was warranted, because the sale did not involve a transfer of US property. Instead, the court found that the property at issue—the claim—was intangible property, owned by and located with the debtor in the BVI, even though the claim was against BLMIS, a US entity that is itself a debtor in a US insolvency proceeding.

The court reasoned that its conclusion was consistent with chapter 15's overriding focus on comity.

First, the court agreed with the Fifth Circuit in *Vitro* that comity was a central objective of chapter 15, and characterized the *Elpida* court as having downplayed the role of comity in chapter 15. Next, the court concluded that the BVI court had the paramount interest in the sale of the claim after the Fairfield-BLMIS settlement had been reached. In addition, the court emphasized that there were "no interests, such as liens or intellectual property, unique to any of the United States parties at issue, and United States creditors have limited interest in the SIPA claim." *Fairfield*, 2013 WL 139185, at *9. Accordingly, the court declined to "offend principles of international comity by second guessing BVI court's approval of the sale when the United States' interests are so minimal." *Id*. The court concluded by noting that chapter 15 "was not designed to permit parties to mix and match multiple countries' laws." *Id*.

The Bottom Line: US Courts in Chapter 15 Cases May Look Afresh at Issues Approved by Foreign Courts, with Differing Results

Contrary to the view that chapter 15 can provide a method for a foreign entity to obtain a US "rubber stamp" on foreign insolvency rulings, the *Vitro*, *Metcalfe*, *Elpida* and *Fairfield* decisions demonstrate that US courts will conduct a careful application of the provisions of chapter 15 to determine whether, how, and to what extent the foreign relief should be analyzed under US principles before any US court approval is granted.[3] In *Metcalfe* and *Elpida*, that careful application led to the approval of the foreign court decisions, but in *Vitro* it led to the opposite result. In *Fairfield*, the application led to the US court deferring entirely to the foreign court's judgment on the basis of comity and the US court's view that no significant US interests were at issue—eliminating the possibility that US standards would provide the foreign representative with an "out" from the deal it had struck.

These decisions mark a stage in the development of chapter 15 jurisprudence that is complex and nuanced, but the varying results are not entirely surprising or without precedent. Chapter 15 is the codification of long-standing principles of comity that have always informed the extent to which US judges defer to foreign courts. These considerations of comity have led to diverging outcomes across a range of circumstances, and experienced advocacy in cross-border cases continues to plays a crucial role in shaping these outcomes.

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[1] US courts may also simply be more comfortable with Canadian insolvency proceedings than those in other countries. In addition to the example of *Metcalfe*, in *Collins v. Oilsands Quest Inc.*, Case No. 12-10476 (JSR), 2012 WL 6709266 (S.D.N.Y. Dec. 27, 2012), the US District Court for the Southern District of New York gave effect to a temporary stay, entered by the Canadian court presiding over the debtor's foreign main proceeding, of actions against the debtor's officers and directors. The US court held that, even though the US court might not have granted the stay if presented with the issue in the first instance, recognizing the Canadian court's order would not be contrary to a fundamental US policy. Thus, denying recognition would not be warranted under the narrow public policy exception contained in section 1506 of the US Bankruptcy Code.

[2] Another recent decision, *Qimonda*, further demonstrates the range of possible outcomes on these

types of chapter 15 matters. In *In re Qimonda AG*, 462 B.R. 165 (Bankr. E.D. Va. 2011), the US Bankruptcy Court for the Eastern District of Virginia went a step further in applying US Bankruptcy Code provisions to a foreign debtor's ancillary proceeding. Relying on the public policy exception contained in section 1506 of the US Bankruptcy Code, the court held that it would be manifestly contrary to the fundamental US policy of promoting technological innovation to allow the foreign representative to reject the debtor's patent licenses without affording the licensees the protections of section 365(n) of the US Bankruptcy Code. The court's decision is currently on appeal to the Fourth Circuit.

[3] Complexities in asset sales in cross-border insolvency proceedings are not limited to the chapter 15 context. In the Nortel insolvency, a highly successful liquidation of the debtors' assets was approved in reorganization proceedings under chapter 11 in the US and under the Companies' Creditors Arrangement Act in Canada, neither of which was ancillary to the other, as well as in proceedings in other jurisdictions. The significant proceeds resulting from the successful liquidation have triggered a drawn-out battle over how the sale proceeds will be distributed among the various insolvency estates worldwide. See Peg Brickley, *Nortel Mediation Efforts Fail*, *Wall Street Journal*, Jan. 25, 2013, available at http://online.wsj.com.

Authors

George W. Shuster Jr.

PARTNER

george.shuster@wilmerhale.com

+1 212 937 7232

Benjamin W. Loveland

PARTNER

benjamin.loveland@wilmerhale.com

+1 617 526 6641