WON'T YOU BE MY NEIGHBOR?

CROSS BORDER INSOLVENCY ISSUES WITH MEXICO

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Doing business in foreign markets can have a significant positive impact on a company's bottom line. Mexico's resurgent economy and proximity to the United States make it an attractive location for companies looking for business and investment opportunities. Working in foreign markets, however, increases exposure to complications that may arise from a counterparty default and/or cross border insolvency. The purpose of this article is threefold: (1) to give an overview of the Mexican insolvency process, (2) to discuss the basics of U.S. Chapter 15 bankruptcy, and (3) to highlight current issues in Mexican cross border insolvencies.

Basics of the Mexican Insolvency Process

Whether it is buying or selling goods, or making or receiving an investment, a company conducting business south of the border must consider the consequences of counterparty default. The purpose of this section is to provide an overview of the Mexican insolvency process.

General Provisions

In May 2000, Mexico enacted the Law on Commercial Insolvencies (*Ley de Concursos Mercantiles* or "LCM"). In 2014, the LCM was amended by the Law Regulating Financial Groups (*Ley para Regular las Agrupaciones Financieras*) (the "LCM Amendments").

Under the LCM, only merchant debtors ("*comerciantes*") may seek insolvency relief under the LCM. *Comerciantes* are defined by the Mexican Code of Commerce as natural or legal persons engaged in trading, commerce, or other business activity whose debts are commercial or business in nature. Small merchants with liabilities under $400,000 UDI[2] can opt out of following the LCM.

The LCM grants original and exclusive jurisdiction of insolvency proceedings to the federal courts. Petitions seeking relief must be filed in the debtor's domicile, which is the debtor's state of incorporation or its principal place of business.

The LCM also established the Federal Institute of Reorganization and Bankruptcy Specialists ("IFECOM"). The IFECOM is generally responsible for: administering insolvency proceedings, appointing supervising officers of the estate and establishing certain procedures for bankruptcy cases.

The LCM also provides for an intervenor to be appointed in insolvency proceedings if creditors holding at least 10% of the amount of allowable claims elect an appointment. The intervenor represents all creditors (secured and unsecured), monitors the debt, and monitors the trustee or conciliator (whose role is discussed in further detail below) in the administration of the case.

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[2] Under the LCM, debt balances are converted into *Unidades de Inversion* ("UDI") which takes into account inflation. Under the pre-2000 Mexican bankruptcy law, credit balances were frozen at the exchange rate at the day of suspension. Anthony M. Sandland, *A Comparison Between the Ley de Quiebras y Suspencion de Pagos and the Ley de Concursos Mercantiles*, 10 U.S.-Mex. L.J. 57 (2002).

Stages of the Mexican Insolvency Proceeding

The Mexican insolvency procedure is broken into three stages: examination, conciliation, and liquidation.

Examination

The examination stage begins once a petition for relief is filed with the court. The court then directs the IFECOM to appoint an examiner, whose duty is to determine if the debtor is insolvent. A debtor in Mexico is insolvent if it is in "general default" on its obligations to two or more creditors, and either:

- the delinquency represents 35% or more of the debtor's liabilities as of the petition date and is more than 30 days past due; and/or,
- the debtor does not have sufficient liquid assets to satisfy at least 80% of its obligations as of the petition-date.

Under the LCM prima facie evidence of a "general default" exists if the debtor:

- has insufficient assets to satisfy a judgment;
- defaults on obligations to two or more creditors;
- is absent or absconds;
- closes the business;
- commits fraudulent or deceitful activities in connection with its obligations;
- breaches obligations under prior plan of reorganization; or,
- performs any other similar act.

Under the LCM Amendments, a debtor or any creditor can request can declaration of insolvency prior to be generally in default if a "general default" will inevitably occur within the following 90 days after the insolvency petition.

The examiner has fifteen days to file a report concluding on the debtor's insolvency. The examiner may also recommend interim measures to protect the debtor and its assets, such as removing management. Once the examiner's report is filed, parties-in-interest have ten days to respond. The court issues a judgment granting or refusing to grant a "concurso" judgment, or order for relief. A concurso judgment provides for suspension of payments, stay of attachments or foreclosures, and the appointment of a conciliator or trustee.

Conciliation

The conciliation stage is the most important stage and is similar to the U.S.'s reorganization procedures. It begins after an order for relief is granted. The main purpose of conciliation is to create a reorganization plan. If the case does not involve a straight liquidation, a conciliator is appointed by the IFECOM. The conciliator oversees the debtor's operation and facilitates the negotiations and implementation of a reorganization plan. The main purpose of the conciliator is to mediate agreements between the debtor and creditors to prevent the case from

entering liquidation. Generally, the debtor remains in possession of the assets and negotiates with the creditors to approve a reorganization plan. The LCM limits this stage to 185 days, but it can be extended by 90 days with approval of two-thirds of the claimants and an additional 90 days if approved by 90% of the claimants. In any case, however, the period can never be extended beyond one year.

The key benefits of conciliation are: automatic stay of claims, pending receivership or foreclosure proceedings are automatically stayed and interest stops accruing.[3] All balances are converted into UDIs.

A reorganization plan requires approval by a majority of creditors holding allowed claims and the debtor. A confirmed plan is binding on unsecured creditors who reject the plan if the plan:

- does not defer payment for more than the minimum term accepted by 30% of the general unsecured creditors that voted to accept the plan;
- reduces its claim to an amount equal to the smallest sum accepted by 30% of the general unsecured creditors that voted to accept the plan; or,
- provides a combination of debt reduction and payment deferral so long as its treatment is identical to the treatment received by 30% of the general unsecured creditors that voted to accept the plan.

Secured creditors who opt-out can continue to enforce their liens, unless paid the full value of the lien and any deficiency is treated like other similarly situated claims. LCM, Art. 160.

Liquidation

A debtor enters the liquidation stage if (i) it petitions for a liquidation rather than reorganization; (ii) a reorganization plan is not approved within a year; or (iii) the conciliator petitions the court to convert a reorganization case to a liquidation case. If the debtor enters liquidation, a trustee is appointed ("*síndico*"). The *Síndico* administers the estate, collects the assets, and runs the business. Thus, unlike the conciliation stage, the debtor does not retain possession of the assets in a liquidation proceeding. The *Síndico* also conducts an auction of the assets and distributes the proceeds to creditors pursuant to the IFECOM's guidelines.

Finally, Title 12 of the LCM provides assistance to foreign courts in cross border insolvencies. Like the U.S. version, Title 12 adopts the Model Law on Cross Border Insolvency (the "Model Law"), which was prepared by the United Nations Commission on International Trade Law ("UNCITRAL"). The following section discusses Chapter 15 of the U.S. Bankruptcy

[3] Some types of claims can make a successful reorganization difficult because they are excepted from automatic stay: labor and tax claims. Under LCM holders of recent labor claims (less than two years) may continue to pursue their claims, even against assets that are being used to effectuate the reorganization plan. Also, governmental entities can continue to pursue certain tax claims, but cannot execute on the assets until after the reorganization. Nathalie Martin, *Que es la diferencia: A Comparison of the First Days of a Business Reorganization Case in Mexico*, 10 U.S.-Mex. L.J. 73 (2002).

Code dealing with cross-border insolvencies which is the United States equivalent of Title 12 of the LCM.

<u>Basics of U.S. Chapter 15 Bankruptcy: Ancillary and Other Cross Border Cases</u>

Sometimes, when a Mexican debtor engaged in an LCM needs the assistance of a United States court or the debtor's reorganization plan is confirmed in Mexico, the debtor will seek enforcement of the provisions of that plan in the United States against its U.S. creditors. This section describes the general provisions of Chapter 15 and how it is used in cross-border insolvency proceedings.

<u>General Provisions</u>

Congress created Chapter 15 of the Bankruptcy Code when it signed The Bankruptcy Abuse, Prevention and Consumer Protection Act of 2005. Chapter 15 seeks to create cooperation among foreign courts in cross-border insolvency proceedings and to protect the interests of all creditors. 11 U.S.C. § 1501. A United States court's determination of a request for assistance from a foreign court must be "consistent with the principles of comity." 11 U.S.C. § 1507. Thus, a determination for relief is based on a due regard to international duty and convenience, and to the rights of U.S. citizens or of other persons under the protection of U.S. law. *Hilton v. Guyout*, 159 U.S. 113, 163–64 (1895). Chapter 15 expressly encourages cooperation and communication with a foreign court or a foreign representative. 11 U.S.C. § 1525. Moreover, it provides procedures and recommendations for communication and cooperation between U.S. case trustees and examiners and foreign counterparts. 11 U.S.C. §§ 1526–1527. Section 1508 further provides that courts should 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." 11 U.S.C. § 1508. Unlike other provisions in the U.S. Bankruptcy Code, Chapter 15 opens with the express purpose "to incorporate the Model Law on Cross Border Insolvency so as to provide effective mechanisms for dealing with cases of cross-border insolvency." 11 U.S.C. § 1501(a).

<u>Foreign Representative and Proceeding</u>

A Chapter 15 proceeding begins when a foreign representative files a petition with a U.S. Bankruptcy Court seeking recognition of a foreign proceeding.[4] 11 U.S.C. § 1504. A foreign representative is one who is appointed to administer the financial restructuring, liquidation, or reorganization of the debtor. 11 U.S.C. § 101(24). An official court appointed foreign representative is not required. The term "foreign representative" includes "debtors in possession, including those that may not meet Chapter 11's definition of debtor-in-possession." *Ad Hoc Group of Vitro Noteholders v. Vitro SAB (In re Vitro SAB de CV),* 701 F.3d 1031, 1042 (5th Cir. 2012) (referred to herein as "*Vitro II*") (holding a Mexican debtor maintained enough control

[4] Section 101(23) of the Bankruptcy Code defines a foreign proceeding as a "collective judicial or administrative proceeding in a foreign country, including an interim proceeding, under a law relating to insolvency or adjustment of debt in which proceeding the assets and affairs of the debtor are subject to control or supervision by a foreign court, for the purposes of reorganization or liquidation." 11 U.S.C. § 101(23); *see U.S. v. J.A. Jones Constr. Group, LLC, 333 B.R. 637, 638* n.2.

over the business to be a debtor-in-possession, and, therefore, could appoints its own foreign representative).

Only after the proceeding is recognized can the foreign representative apply directly to a United States court for relief. *In re Vitro II*, 701 F.3d at 1044 (citing *U.S. v. J.A. Jones Constr. Group, LLC*, 333 B.R. 637, 638 (E.D.N.Y. 2005)). At a minimum, the foreign representative must provide documentation or certification from the foreign court confirming the existence of the proceeding and his or her authority.

A petition for recognition must include: "(1) a certified copy of the decision commencing the foreign proceeding and appointing the foreign representative, (2) a certificate from the foreign court affirming the existence of the foreign proceeding and of the appointment of the foreign representative, or (3) in the absence of evidence referred to in paragraphs (1) and (2), any other acceptable evidence establishing the existence of the foreign proceeding and appointment of the representative." 11 U.S.C. § 1515(b); *see also In re Artimm*, *S.R.L.*, 335 B.R. 149, 158 (Bankr. C.D. Cal. 2005).

Proper Venue

The same general venue principles that apply in other bankruptcy cases apply to Chapter 15 cases. A Chapter 15 case may be brought in either (i) the district where the debtor has its principal place of business or principal assets in the United States; (ii) where there is a pending action against the debtor; or (iii) a venue which is consistent with the interest of justice and fairness of the parties. 28 U.S.C. § 1410.

Debtor Requirements

Chapter 15 expressly incorporates the limitations of Section 109(b) of the Bankruptcy Code, which specify who may seek relief. 11 U.S.C. § 1501(c). Thus, a foreign corporation that has a domicile, residence, place of business, or property in the United States can obtain relief under Chapter 15. Railroads or banking institutions with a branch or agency in the United States are excluded. 11 U.S.C. § 109(a)–(b).

In bankruptcy proceedings, a corporation's domicile is its state of incorporation. *Hoffman v. Bullmore (In re Nat'l Warranty Ins. Risk Retention Group)*, 306 B.R. 614, 620 (B.A.P. 8th Cir. 2004) (citing *Underwood v. Hilliard* (*In re Rimsat, Ltd.*), 98 F.3d 956, 960 (7th Cir. 1996)). Thus, if the debtor is incorporated abroad it must rely on residency, place of business, or property in the United States to satisfy the requirements of section 109 of the Bankruptcy Code. *See GMAM Inv. Funds Trust I v. Globo Comunicacoes e Participacoes S.A.* (*In re Globo Comunicacoes e Participacoes S.A.*), 317 B.R. 235, 349 (S.D.N.Y. 2004) (noting that a foreign debtor with no residence or place of business in the U.S. may still qualify for relief under Section 109 if it has property in the U.S.).

Moreover, the U.S. courts generally consider petitions for relief based on the debtor's place of business or property because residency can be difficult to determine. Notably, the statute does not require a *principal* place of business, just *a* place of business. 11 U.S.C. § 109(a). As a

result, the debtor's formation documents are not dispositive and the place of business does not need to be formal. *In re Zais Inv. Grade Ltd. VII*, 455 B.R. 839 (Bankr. D.N.J 2011) (citing *In re Paper I Partners, L.P.*, 283 B.R. 661, 672 (Bankr. S.D.N.Y. 2002)). Even a single employee's continuous presence in the United States can support a place of business. *In re Paper I Partners, L.P.*, 283 B.R. at 673 (citing *In re Petition of Brierley*, 145 B.R. 151, 161 (Bankr. S.D.N.Y. 1992)). Just having some business in the United States, however, even a physical presence, for only part of the year is not sufficient to establish a place of business. *In re Global Ocean Carriers Ltd.*, 251 B.R. 31, 37 (Bankr. D. Del. 2000).

Generally, it is easier for a debtor to prove it is entitled relief if it has real property in the United States because real property is easily locatable and quantifiable. Bank accounts are considered property under Section 109 of the Bankruptcy Code, regardless of how much is in the account on the filing date and even a *de minimis* presence can establish jurisdiction. *In re Global Ocean Carriers*, 251 B.R. at 38; *In re Yukos Oil Co.*, 321 B.R. 396 (Bankr. S.D. Tex. 2005) (concluding that funds deposited in a U.S. bank account just before filing the bankruptcy petition is sufficient to establish property under Section 109 of the Bankruptcy Code). Therefore, even "nominal amounts of property located within the United States enable a foreign corporation to qualify as a debtor under Section 109(a)." *In re Yukos Oil Co.*, 321 B.R. at 407. Several courts have noted there is "virtually no formal barrier to having federal courts adjudicate foreign debtors' bankruptcy proceedings." *Id.* at 407; *In re Globo Comunicacoes*, 317 B.R. at 249.

Main and Non-Main Proceedings

After the foreign representative files a petition and there is a hearing, the U.S. judge may enter an order recognizing the foreign proceeding as a main or non-main proceeding. The concept of recognition is distinct from recognition as a foreign main proceeding. *In re SPhinX, LTD.*, 351 B.R. 103, 115 (Bankr. S.D.N.Y. 2006). A main proceeding is "pending in the country where the debtor has the center of its main interests." 11 U.S.C. § 1502(4). Even though the Bankruptcy Code does not define "center of main interests" ("COMI") section 1516 of the Bankruptcy Code provides that, "in the absence of evidence to the contrary, the debtor's registered office is presumed to be the center of the debtor's main interests."[5] 11 U.S.C. § 1516.

This presumption can be rebutted based on where the debtor is headquartered, the location of management, the location of primary assets, and the location of the majority of creditors. *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd.*, 374 B.R. 122, 128 (Bankr. S.D.N.Y. 2007), *aff'd* 389 B.R. 325 (S.D.N.Y. 2008) (referred to herein as "*Bear I*") (citing *In re SPhinX, Ltd.*, 351 B.R. at 117). In *In re SPhinX,* the court denied a petition to recognize a Cayman Island proceeding as a foreign main proceeding, even though the debtor was registered in the Cayman Islands. The court in *In re SPhinX* found the presumption sufficiently rebutted because almost all the debtor's assets were located outside the Cayman Islands, there were no employees or managers in the Cayman Islands, and almost all of the creditors were located outside the Cayman Islands. *In re SPhinX*, 351 B.R. at 119. Additionally, the Cayman Island court would have to rely on assistance from foreign courts to realize the

[5] Courts have also equated COMI with the concept of a "principal place of business." *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd.*, 389 B.R. 325, 336 (S.D.N.Y. 2008). (citing *In re Tri-Continental Exch.*, 349 B.R. 627, 634 (Bankr. E.D. Cal. 2006)).

debtor's assets and obtain jurisdiction over the creditors. *Id.* Other than being registered in the Cayman Islands, the debtor had no other presence in the Islands. Based on these considerations, the court recognized the proceeding as a non-main foreign proceeding.[6] *Id.* at 122.

Even if no party objects, the court may still take up the analysis *sua sponte*. *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd.*, 389 B.R. 325, 335 (S.D.N.Y. 2008) (referred to herein as "*Bear II*"). In *Bear II,* no interested party objected to the representatives petition to recognize the Cayman Islands as the debtor's "center of main interests." *Bear II* at 336. But, the court stated, "although the courts may presume that a debtor's COMI is in the place of its registered offices, this presumption may be rebutted…even in the case of an unopposed petition for recognition." *Id.* (citing *In re Basis Yield Alpha Fund (Master)*, 381 B.R. 37 (Bankr. S.D.N.Y. 2008)). Even though Section 1516 of the Bankruptcy Code provides a presumption that the debtors COMI is where it is registered, the court may still review an unopposed petition for COMI if the objective factors established in *SPhinX* suggest otherwise.

Several courts have held the date of the Chapter 15 petition is the appropriate date to determine a debtor's COMI. *Lavie v. Ran (In re Ran)*, 607 F.3d 1017, 1025 (5th Cir. 2010); *In re Betcorp Ltd.*, 400 B.R. 266, 292 (Bankr. D. Nev. 2009). However, in *In re Millennium Global Emerging Credit Master Fund Ltd.,* the court held that COMI should be determined at the commencement of the foreign proceeding seeking recognition, not the Chapter 15 petition date. 458 B.R. 63, 76 (Bankr. S.D.N.Y 2011) (stating the date of the petition for recognition is a matter of "happenstance"). The use of the later date, the court reasoned, could lead to abusive forum shopping. *Id.* The court also explained that if COMI is equated with the concept of "principal place of business," the place of business must be determined before it enters into liquidation because once it enters liquidation it is no longer operating. *Id.* at 73. Furthermore, even in reorganization the principal place of business is of the reorganizing entity, not the debtor. *Id.* Therefore, the term COMI must refer to the date of the commencement of the foreign proceeding for which recognition is sought. *Id.* at 76. *Millennium* was effectively overruled by the Second Circuit in *In re Fairfield Sentry Limited*[7] where the court concluded that a debtor's COMI should be determined as of the time of the filing of the Chapter 15 petition. To offset a debtor's ability to manipulate its COMI, a court may also look at the time period between the initiation of the foreign liquidation proceeding and the filing of the Chapter 15 petition.

If the foreign proceeding is not a main proceeding, the court may instead recognize the foreign proceeding as a non-main proceeding. Section 1502(5) of the Bankruptcy Code defines a foreign non-main proceeding as a foreign proceeding "pending in a country where the debtor has an establishment." 11 U.S.C. § 1502(5). An establishment is "any place of operations where the debtor carries out nontransitory economic activity." 11 U.S.C. § 1502(2). Recognition as a main versus nonmain proceedings impacts the type of relief available. The following section discusses the differences in available relief.

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[6] The court in *In re SPhinX* addressed the question of whether there can be a foreign non-main proceeding if there may never be a foreign main proceeding. The court concluded that, "nothing in Chapter 15 provides that there cannot be a 'nonmain' proceeding unless there is a 'main' proceeding." *In re SPhinX, Ltd.*, 351 B.R. at 122. The recognition by the court of Cayman proceeding for the debtor as a non-main proceeding has been questioned.

[7] *In re Fairfield Sentry Ltd.*, 714 F.3d 127 (2d Cir. 2013).

Relief Upon Recognition

Recognition as a foreign main proceeding immediately grants the foreign representative all the rights ordinarily available under Chapter 11 of the Bankruptcy Code. The foreign representative may also file a full voluntary Chapter 11 bankruptcy case. Furthermore, the following relief is automatically granted upon recognition as a main proceeding: (i) automatic stay of actions against the debtor (subject to the limitations contained in Section 362 of the Bankruptcy Code); (ii) secured creditors entitled to receive adequate protection similar to Section 361 of the Bankruptcy Code; (iii) the foreign representative is able to sue and be sued in the United States; (iv) the United States court is able to order examination of witnesses like in Rule 2004 examination; and (v) the foreign representative may be permitted to administer and realize some or all of the debtor's assets. 11 U.S.C. § 1520.

Unlike a foreign main proceeding where the foreign representative may file a voluntary Chapter 11 case, a foreign non-main proceeding only allows the foreign representative to file an involuntary Chapter 11 case. Also, Chapter 15 of the Bankruptcy Code does not grant automatic relief to non-main proceedings. The court may grant certain relief, however, including, but not limited to, staying the commencement or continuation of certain action against the debtor, and suspending the right of others to transfer or otherwise dispose of the debtor's assets. 11 U.S.C. § 1521. Any relief granted under Section 1521of the Bankruptcy Code must be necessary to effectuate Chapter 15's purpose and protect the assets of the debtor. Unlike the provisions of section 1520 of the Bankruptcy Code which are automatic to foreign main proceedings, foreign non-main proceedings are only granted relief under this provision if "the interests of the creditors and other interested entities, including the debtor, are sufficiently protected." 11 U.S.C. § 1522(a). The court is granted discretion to determine whether relief should be granted to a foreign nonmain proceeding after notice and a hearing. *In re Ran*, 607 F.3d at 1026. In short, recognition as a foreign main proceeding provides greater rights to relief than recognition as a non-main proceeding.

Section 1507(a) of the Bankruptcy Code also provides United States courts the ability to provide "additional assistance" to a foreign representative under the Bankruptcy Code or other U.S. laws. This section does not define what other assistance is available, but the language suggests that foreign representatives could be granted relief beyond Sections1519, 1520, and 1521. *See* 11 U.S.C. § 1507(a). Any additional relief must be consistent with the principles of comity and consider the following: (1) the just treatment of holders of claims against or interests in the debtor's property; (2) the protection of claim holders in the U.S. against prejudice and inconvenience in the processing of claims in a foreign proceeding; (3) the prevention of preferential or fraudulent property dispositions; (4) the distribution of proceeds of the debtors' property in accordance with the court order recognizing the foreign proceeding; and (5) the opportunity for a fresh start, when applicable. 11 U.S.C. § 1507(b). Requests for relief under sections 1521 or 1507 of the Bankruptcy Code must be by written motion under Bankruptcy Rule 9013, which requires notice to interested parties.

Public Policy Exception

Chapter 15 is based on the Model Law, prepared by UNCITRAL, with significant input from insolvency practitioners all over the world.[8] It was designed to create procedures for cooperation among foreign courts where insolvency proceedings are pending in more than one country and establish guidelines for the protection of assets internationally, while being sensitive to the political issues and differing legal systems of the countries involved. Any determination of a request for assistance under Chapter 15 must be "consistent with the principles of comity."[9]

> "Comity," in the legal sense, is neither a matter of absolute obligation, on the one hand, nor of mere courtesy and good will, upon the other. But it is the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws.[10]

The grant of comity is not discretionary; however, the determination of whether a court should grant comity is balanced by provisions of Chapter 15, including the language of section 1506 of the Bankruptcy Code, which provides that "[n]othing in this chapter 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."[11] Whether a request for relief or assistance is "manifestly contrary" to United States public policy is within the discretion of the bankruptcy court to determine.[12]

Presumably to aid with evaluating recognition relief and comity considerations, some bankruptcy courts have adopted guidelines to streamline the dual-track process of cross border proceedings. Moreover, there are many cases, some of which are summarized herein, that have directly addressed the issues that surround the recognition of foreign representatives and the enforcement of orders in foreign insolvency proceedings.

Court Implemented Guidelines Regarding Cross-Border Insolvency Matters

The Bankruptcy Court for the Southern District of Texas

Effective January 31, 2019, Bankruptcy Court for the Southern District of Texas entered the *Guidelines for Communication and Cooperation Between Courts in Cross-Border Insolvency Matters* (the "SDTX Guidelines"). The SDTX Guidelines states that "the overarching objective of these Guidelines is to improve in the interest of *all stakeholders* the efficiency and effectiveness of cross-border proceedings relating to insolvency or adjustment of debt opened in

[8] *U.S. v. J.A. Jones Constr. Grp., LLC*, 333 B.R. 637, 638 (E.D.N.Y. 2005).

[9] 11 U.S.C. § 1507; *see J.A. Jones,* 333 B.R. at 638.

[10] *Hilton v. Guyot*, 159 U.S. 113, 163-64 (1895).

[11] 11 U.S.C. § 1506.

[12] *Micron Tech., Inc. v. Qimonda AG. (In re Qimonda AG Bankr. Litig.)*, 433 B.R. 547, 565 (E.D. Va. 2010) [Hereinafter *Qimonda I*].

more than one jurisdiction ('Parallel Proceedings')." The SDTX Guidelines can be implemented in Parallel Proceedings "in each jurisdiction in such manner as the jurisdiction seems fit" by "a protocol or an order."

The SDTX Guidelines include various guiding principles for Parallel Proceedings, including (i) encouraging all administrators to cooperate, (ii) allowing domestic and foreign courts to communicate directly to make orderly decisions, (iii) ensuring appropriate notice of proceedings in other jurisdictions, and (iv) except under a proper objection, recognizing and accepting foreign statutes, regulations, and rules to the extent applicable.

The Bankruptcy Court for the District of Delaware

The Bankruptcy Court for the District of Delaware implemented local rule 9029-2: *Guidelines for Communication and Cooperation Between Courts in Cross-Border Insolvency Matters* (the "Delaware Guidelines"). Similar to the SDTX Guidelines, the Delaware Guidelines apply on application of a party or if implemented *sua sponte* by the court. The Delaware Guidelines and the SDTX Guidelines are virtually identical.[13]

Case Law Review of Cross-Border Insolvency Matters

In re Ephedra Products Liability Litigation

On August 11, 2006, United States District Judge Jed S. Rakoff for the Southern District of New York issued an opinion relating to the Chapter 15 case of *In re Muscletech Research and Development, Inc.* and in general the *In re Ephedra Products Liability Litigation*.[14] The district court held that the Claims Resolution Procedures negotiated in the Canadian Proceeding and enforced through the Chapter 15 proceeding in the U.S. were not manifestly contrary to United States public policy.

Factual Background

Muscletech Research and Development, Inc. ("Muscletech") marketed products that contained ephedra prior to the FDA banning the substance in 2004. The sometimes harmful side-effects of ephedra led to more than thirty separate actions for personal injury and wrongful death to be brought against Muscletech in both state and federal court. As a means of managing its liability, Muscletech commenced an insolvency proceeding in Canada (the "Canadian Proceeding"). RSM Richter, Inc. was appointed as Monitor (the "Monitor") of Muscletech and eventually sought and was granted recognition of the Canadian proceeding as a foreign main proceeding in the United States under Chapter 15. As a result of recognition under Chapter 15, the state and federal civil actions were transferred and consolidated in the district court before Judge Rakoff.

[13] The Bankruptcy Court for the Southern District of New York has also adopted these same guidelines. *See* General Order M-511.

[14] *In re Ephedra Prods. Liab. Litig.*, 349 B.R. 333 (S.D.N.Y. 2006).

In the Canadian Proceeding, the Monitor negotiated a procedure for speedily assessing and valuing creditors' claims, including those of the U.S. plaintiffs, all of which had filed claims in the Canadian Proceeding. The Monitor then sought enforcement of these procedures in the U.S. through the Chapter 15 by filing a motion under sections 105(a) and 1521(a) of the Bankruptcy Code. Four parties objected to the motion arguing that enforcement of such an order in the U.S. would be manifestly contrary to public policy because it deprives the objectors of due process and the right to a jury trial.

The Bankruptcy Court's Decision

The district court, due to a few amendments having already been made to the order the objectors were attacking, quickly dismissed any arguments that the procedures would violate due process rights. Regarding the right to trial by a jury, the Monitor argued that the objectors waived their right when they filed claims in the Canadian Proceeding. The district court addressed the issue by reflecting upon the limited nature of the public policy exception provided by section 1506 of the Bankruptcy Code. Referring to *Hilton v. Guyot* and a long line of other cases, the district court explained that not affording the objectors the right to a jury trial does not inherently make the procedures manifestly contrary to U.S. public policy.

Although 28 U.S.C. § 1411 represents the importance the U.S. has placed in retaining the right to jury trials in the context of personal injury cases, the lack of a jury does not prevent a verdict from being fair and impartial. The district court explained that the objectors' main thrust of their argument was that the lack of a right to a jury trial would weaken their bargaining position in settlement negotiations. The district court disagreed, stating that "[d]eprivation of such bargaining advantage hardly rises to the level of imposing on plaintiffs some fundamental unfairness." *In re Ephedra Products Liability Litigation*, 349 B.R. at 337. Because the objectors would still retain the right to a fair and impartial proceeding, the district court held that the enforcement of the procedures would not be manifestly contrary to public policy.

In re Petition of Ernst & Young, Inc.

Ernst & Young, Inc. filed a petition for recognition of a foreign main proceeding on behalf of Klytie's Developments, Inc. ("KDI"), a Canadian entity formed by two Israeli citizens for the development of real estate throughout the world.[15] The parties opposing the petition argued that the recognition of KDI's foreign proceeding would be manifestly contrary to public policy because (1) Colorado and American investors would receive less in the foreign proceeding than they would receive in a proceeding run in Colorado or federal court and (2) the costs of running the proceeding outside of the United States would deplete the assets of KDI. The court did not find either argument persuasive and held that there was no evidence to support a finding that recognition of the foreign proceeding would be manifestly contrary to public policy.

[15] *In re Pet. of Ernst & Young, Inc.*, 383 B.R. 773, 774 (Bankr. D. Colo. 2008).

Cozumel Caribe, S.A. de C.V.

On November 14, 2012 New York Bankruptcy Judge Martin Glenn entered an order in the *Cozumel Caribe* case substantially enforcing an order granted to a Mexican debtor in a *Concurso* proceeding in Mexico.[16] The foreign representative of the debtor sought a stay of an adversary proceeding brought by a secured creditor regarding the respective ownership of funds in the United States by the debtor and its non-debtor affiliates. A comprehensive stay covering the debtor, its non-debtor affiliates and two individual guarantors had been ordered in 2010 by the Mexican court. After two years of sporadic litigation by the parties in both Mexico and the United States, the secured creditor sought a determination from Judge Glenn regarding the funds. The foreign representative of the debtor had filed a Chapter 15 proceeding and obtained recognition and a temporary order freezing the contested funds in 2010.

The first issue confronting Judge Glenn was whether a prior decision of a United States District Court that concluded that recognition of the foreign representative under section 1509 of the Bankruptcy Code required granting comity to the Mexican stay order unless it was manifestly contrary to the public policy of the United States under section 1506 of the Bankruptcy Code was preclusive. Judge Glenn concluded that the District Court ruling involved only one small section of the Mexican stay order and was not determinative, noting that the District Court's interpretation of section 1509 of the Bankruptcy Code eliminated the discretion granted to the court under several other provisions of Chapter 15 and that section 1509 of the Bankruptcy Code only required granting comity to the foreign representative, not to every ruling of the foreign court.

Judge Glenn determined that the secured creditor was sufficiently protected, as required by section 1522 of the Bankruptcy Code, as long as the contested funds remained in the United States, and continued the temporary enforcement of the Mexican stay order for 180 days. Judge Glen also required the debtor and the foreign representative to commence an appropriate proceeding in the Mexican court to determine the contested issues regarding the funds in question. The parties were to report back to Judge Glenn, who would then determine whether or not to continue to enforce the Mexican stay order. In arriving at his order, Judge Glenn found that the request of the foreign representative was not manifestly contrary to the public policy of the United States.

In re Qimonda AG

In re Qimonda AG is a significant case involving recognition of a foreign representative and the issue of whether relief requested of the court was manifestly contrary to public policy. On October 28, 2011, the Bankruptcy Court for the Eastern District of Virginia issued an opinion in the Chapter 15 case of Qimonda AG ("Qimonda").[17] The bankruptcy court held that the application of section 365(n)[18] of the Bankruptcy Code to executory licensees to U.S. patents

[16] *CT Inv. Mgmt. Co. v. Cozumel Caribe, S.A. de C.V. (In re Cozumel Caribe, S.A. de C.V.*), 482 B.R. 96 (Bankr. S.D.N.Y. 2012).

[17] *In re Qimonda AG,* 462 B.R. 165 (Bankr. E.D. Va. 2011).

[18] Section 365(n) of the Bankruptcy Code provides that if a trustee or debtor-in-possession rejects an intellectual property contract between a debtor/licensor and a licensee, the licensee may elect to either treat the contract as

was required to sufficiently protect the interests of U.S. patent licensees under Chapter 15 of the Bankruptcy Code and that the failure of German insolvency law to protect patent licensees was "manifestly contrary" to United States public policy.

Factual Background

Qimonda, a manufacturer of semiconductor memory devices headquartered in Munich, Germany, filed an insolvency proceeding in Munich (the "Munich Proceeding"), and Dr. Michael Jaffé ("Jaffé") was appointed as the insolvency administrator. Jaffé then filed a petition for recognition under Chapter 15 of the Bankruptcy Code in the United States Bankruptcy Court for the Eastern District of Virginia. The bankruptcy court recognized the Munich Proceeding as a foreign main proceeding.[19]

Qimonda owned thousands of patents, including U.S. patents. After being unable to sell small packages of the patents, Jaffé decided the best way to realize the value of the patent portfolio was to license the patents and renegotiate existing patent agreements to achieve greater royalties. Jaffé provided notice that Qimonda would not perform under their existing patent licenses pursuant to section 103 of the German Insolvency Code, which provides that executory contracts are automatically unenforceable unless the insolvency administrator, in this case Jaffé, affirmatively elects to perform the contracts. Section 103 of the German Insolvency Code does not provide the same type of protection that is available under section 365(n) of the Bankruptcy Code.

Two U.S. patent licensees, Samsung Electronics Co., Ltd. and Elpida Memory, Inc. (collectively, the "U.S. Licensees"), responded to Jaffé's notice by asserting that they were entitled to the protections of section 365(n) of the Bankruptcy Code. In an effort to convince the bankruptcy court that he did not intend to take advantage of the U.S. Licensees, Jaffé filed pleadings committing to re-license Qimonda's patent portfolio at a reasonable and non-discriminatory royalty to be determined through good faith negotiations or through arbitration.

The Bankruptcy Court's Decision

The bankruptcy court explained that the semiconductor industry is characterized by the existence of a "patent thicket," such that any given semiconductor device may incorporate technologies covered by a multitude of patents not owned by the manufacturer, and it is difficult, if not impossible, to identify all potential patents or design around each and every patented technology. As a result, semiconductor manufacturers must obtain licenses to many different patents prior to developing new technologies to avoid infringement claims.

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terminated or retain its rights under the contract (including the right to enforce any exclusivity provision of the contract, but excluding any rights to specific performance) for the duration of the contract and any extension period available to the licensee under nonbankruptcy law.

[19] The bankruptcy court later entered a supplemental recognition order making section 365 of the Bankruptcy Code applicable to the Chapter 15 proceeding. The provisions of section 365 of the Bankruptcy Code do not apply automatically in a Chapter 15 proceeding. Instead, a foreign representative or other party-in-interest must petition the court to apply section 365 of the Bankruptcy Code pursuant to section 1521 of the Bankruptcy Code.

Congress included section 365(n) in the Bankruptcy Code to remove what had become an unintended burden on American technological development. The court explained that in the absence of appropriate cross-license agreements in the semiconductor industry, "design freedom" gives way to a "hold-up premium" because manufacturers must attempt to license patented technology after potential infringement has already occurred and after an initial, nonrecoverable investment has been made in anticipation of new production.

Jaffé's expert testified that there was no reason to believe that innovation would be harmed given Jaffé's commitment to re-license the Qimonda patent portfolio on reasonable and non-discriminatory terms. Jaffé's expert also explained that a decision applying section 365(n) would only preserve rights in the licensing of U.S. patents, not the non-U.S. patents, which would have to be renegotiated. Jaffé's expert calculated that Qimonda would lose approximately $47 million dollars in revenues if the U.S. Licensees did not have to pay for the continued right to use the U.S. patents.

The court first addressed whether limiting the applicability of section 365(n) "appropriately balanced" the interests of Qimonda and the U.S. Licensees. The court determined that the application of section 362(n) of the Bankruptcy Code to the U.S. patents was required to ensure that the interests of the U.S. Licensees were "sufficiently protected" under section 1522(a) of the Bankruptcy Code. While the court recognized that the "hold-up premium" caused by requiring the re-license of the U.S. patents was lessened by Jaffé's promise to re-license the U.S. patents on reasonable and non-discriminatory terms, the risk to the substantial investments that the U.S. Licensees had made in research and manufacturing facilities in reliance on the design freedom provided by the agreements outweighed any loss of revenue to the Qimonda estate.

The court then addressed whether granting comity to German insolvency law would be "manifestly contrary to the public policy of the United States" within the meaning of section 1506 of the Bankruptcy Code. The court explained that the public policy exception to granting comity to applicable foreign law must be limited to the *most fundamental policies* of the United States, and the fact that application of foreign law results in a different outcome than applying U.S. law is insufficient to deny comity. The court explained that in order to be manifestly contrary to public policy, foreign law must either (i) be procedurally unfair or (ii) severely impinge a U.S. statutory or Constitutional right in a way that would offend the most fundamental policies and purposes of such right.

The court acknowledged that no party had claimed, nor was there any reason to find, that German insolvency law or proceedings were procedurally unfair. Instead, the court focused on the second basis for the public policy exception to comity. The court determined that German insolvency law, as it applies to licenses to U.S. patents, implicated the statutory right found in section 365(n) of the Bankruptcy Code. While the bankruptcy court recognized that Congress did not make the protection of section 365(n) of the Bankruptcy Code automatic upon recognition in a Chapter 15 proceeding, and that the harm discussed in the legislative history of section 365(n) of the Bankruptcy Code differed from the "hold-up premium" discussed by the U.S. Licensees, the court determined that the uncertainty resulting from not applying section 365(n) of the Bankruptcy Code would slow the *pace* of innovation to the detriment of the U.S. economy and that under the circumstances of this case and *this industry* the failure to apply

section 365(n) of the Bankruptcy Code would "severely impinge" an important statutory protection accorded licensees of U.S. patents and thereby undermine a fundamental U.S. public policy promoting technological innovation.

The Fourth Circuit Affirms the Bankruptcy Court

Jaffé appealed the bankruptcy court's decisions and the district court certified the issues for direct appeal to the court of appeals. The Fourth Circuit addressed two issues: (i) whether the bankruptcy court correctly denied Jaffé's request to not apply section 362(n) of the Bankruptcy Code pursuant to section 1522(a) and the need to ensure the licensees were "sufficiently protected" and (ii) whether the bankruptcy court appropriately applied section 1506 of the Bankruptcy Code to preclude Jaffé from unilaterally canceling the licenses. *Jaffe v. Samsung Elecs. Co., Ltd.*, 737 F.3d 14, 18 (4th Cir. 2013).

The Fourth Circuit upheld the bankruptcy court's rulings. The Fourth Circuit found that section 1522(a) of the Bankruptcy Code requires a balancing test and interests of creditors, other entities, and the debtor, are all required to be considered in the determination of whether to grant discretionary relief. The Fourth Circuit also found that the bankruptcy court "reasonably exercised its discretion" to balance the interests of the licensees against the debtor to require application of section 362(n) of the Bankruptcy Code, despite Jaffé's request for discretionary relief to not apply it.

Questions remain as to whether other courts would reach the same conclusions in other Chapter 15 cases involving intellectual property given the *Qimonda* bankruptcy court's limitation of its holdings to these particular circumstances and the semiconductor industry.[20]

In re Toft

On July 22, 2011, Bankruptcy Judge Allan L. Gropper for the Southern District of New York issued an opinion in the Chapter 15 case of *In re Dr. Jürgen Toft*. The court declined to grant recognition to a German administrator because the "order of recognition on the terms requested would be manifestly contrary to U.S. public policy."[21]

Factual Background

Creditors of Dr. Jürgen Toft ("Toft") filed a bankruptcy petition in a German insolvency court hoping to collect debts owed by Toft. The German court appointed Dr. Martin Prager ("Prager") as insolvency administrator to investigate Toft's affairs and attempt to locate Toft's assets. Toft proved to be uncooperative and evasive and began selling estate assets without the German court's permission, squandering the opportunity for his creditors to receive any sort of recovery. In an effort to prevent further loss of estate assets, Prager obtained orders in Germany

[20] *But see* Daniel A. Nolan IV, Comment, *A "Fundamental" Problem: The Vulnerability of Intellectual Property Licenses in Chapter 15 and the Meaning of § 1506*, 28 EMORY BANKR. DEV. J. 177, 224 (2011) (advocating for bankruptcy courts to continue to find protection of intellectual property licenses as a fundamental public policy of the United States when foreign courts allow total rejection of licenses).

[21] *In re Toft*, 453 B.R. 186, 201 (Bankr. S.D.N.Y. 2011).

and England that allowed Prager to intercept Toft's postal mail and e-mail, providing information for Prager's investigation.

Prager filed a Chapter 15 petition for recognition of a foreign main proceeding with the Bankruptcy Court for the Southern District of New York. Along with the petition, Prager sought *ex parte* interim relief in the form of a court order allowing him access to Toft's two e-mail accounts stored on servers located in the U.S. as well as the redirection of future e-mails from these accounts.

The Bankruptcy Court's Decision

In support of the requested interim relief, Prager appealed to the principle of comity and argued that the court should enter an *ex parte* order similar to the German and English orders already obtained and grant Prager access to Toft's e-mail accounts. The court held that the requested relief would be manifestly contrary to public policy because disclosure of Toft's e-mails would violate the Electronic Communications Privacy Act, a bankruptcy trustee would not be entitled to such relief, and Chapter 15 relief cannot ordinarily be obtained without notice to the debtor.

The court began by addressing the Wiretap Act and the Stored Communications Act, each a sub-part of the Electronic Communications Privacy Act (the "Privacy Act").[22] The Wiretap Act imposes criminal and civil penalties on a person who intentionally intercepts electronic communications. The court found that allowing Prager secret access to Toft's e-mail accounts would compromise Toft's privacy rights, which are protected by a comprehensive statutory scheme founded on the fundamental rights protected by the Fourth Amendment and many of the States' constitutions.[23]

The court next looked to the powers typically granted to a representative of an estate under U.S. law. Prager sought the right to inspect Toft's e-mail accounts by pointing to (i) the broad nature of Federal Rule of Bankruptcy Procedure 2004, (ii) case law supporting a bankruptcy trustee's ability to obtain a court order to search an uncooperative debtor's home, and (iii) cases that allowed a bankruptcy trustee to intercept a debtor's postal mail. The court declined to see the parallels in each instance. While Bankruptcy Rule 2004 is broad and may be commenced by an *ex parte* motion, the procedures do not remain secret once an order is entered. Additionally, in the context of e-mails, the plain language of the Privacy Act provides procedures that allow for "wiretaps," which are only available to law enforcement officials and, in most instances, are only available to those parties who can obtain a search warrant under Federal Rule of Criminal Procedure 41(a). A bankruptcy trustee is not one of those parties. Finally, the court pointed to differences between each of the cases allowing a trustee to inspect a home or intercept postal mail and the secret nature of the relief Prager requested. In each case, the debtor was either notified prior to the inspection of the home or the mail or other measures were made to maintain privacy interests. Prager's request did not include these safeguards.

[22] 18 U.S.C. § 2511, *et seq.*

[23] *Toft*, 453 B.R. at 198. The Privacy Act protects both aliens and U.S. citizens. *Id.*

The court last addressed Prager's request to refrain from providing notice to Toft. The court noted that Bankruptcy Rule 2002(q) was specifically included to require notice in Chapter 15 cases; thus, presumably only a rare situation would allow for the court to disregard Rule 2002(q). The court decided this was not such a situation.

The court found that under all three principles, privacy, powers of estate representatives, and notice, not only would the requested relief be contrary to United States law, it would be manifestly contrary to public policy to grant such relief. In contrast to the German and English rulings, the United States court denied Prager's motion for *ex parte* relief in its entirety.

In re Gold & Honey, Ltd.

In *In re Gold & Honey, Ltd.* the Bankruptcy Court for the Eastern District of New York issued an opinion that denied the recognition of foreign main proceedings because they were pursued in violation of the automatic stay.[24] Following the seizure of assets and the commencement of an Israeli receivership proceeding in July of 2008, Gold & Honey, Ltd. and Gold & Honey (1995) L.P. (the "Debtors") filed for Chapter 11 relief in the Eastern District of New York in September of 2008. The court entered an order specifying that the automatic stay applied to all assets of the Debtors, wherever they are located. Despite the application of the automatic stay, the Debtor's lender continued to pursue the receivership in Israel, and eventually obtained the appointment of receivers, who subsequently filed Chapter 15 petitions in the United States.

The court refused to recognize the Israeli receivers' petitions because they were appointed in violation of the automatic stay and because the proceedings were not "foreign proceedings" under the Bankruptcy Code because they were not collective in nature. The court explained that acquiescing to a creditor's offensive violation of the automatic stay would "ensue in derogation of fundamental United States policies" and would be manifestly contrary to public policy under section 1506 of the Bankruptcy Code.[25]

In re think3 Inc.

In re think3 Inc. is a Chapter 11 case filed in the Bankruptcy Court for the Western District of Texas. think3 is a Delaware corporation and a global leader in the computer-aided design and product lifecycle management software market. A dispute arose when Italian creditors (including the Italian government) filed an involuntary insolvency against think3 and its Italian subsidiary in Italy and the Italian court appointed a trustee in Italy (the "Italian Trustee"). Shortly after commencement of proceedings in Italy, think3 filed for relief under Chapter 11 in the Western District of Texas. The Italian Trustee sought recognition of the Italian proceeding as the foreign main proceeding under Chapter 15 in the Western District of Texas.

The bankruptcy court ultimately denied the Italian Trustee's petition for recognition, refusing to grant recognition as a foreign main proceeding or a foreign non-main proceeding. Although the court's decision was not based on whether recognition would be manifestly

[24] *In re Gold & Honey, Ltd.*, 410 B.R. 357, 373 (Bankr. E.D.N.Y. 2009).

[25] *Id.* at 371–72.

contrary to public policy, think3 argued that recognition would be manifestly contrary in its objection to the Italian Trustee's petition. think3 raised the argument because (1) the Italian Trustee had refused to comply with discovery requests, (2) the Italian Trustee's unilateral termination of a License Agreement violated 365(n) under the same theory as *Qimonda*, and (3) the Italian Trustee continued to take actions in violation of the automatic stay.

In re Vitro, S.A.B. de C.V.

On June 13, 2012, the United States Bankruptcy Court for the Northern District of Texas (the "Bankruptcy Court") published an opinion ruling on whether the Mexican Plan of Reorganization (the "Concurso Plan") of the Mexican glass-manufacturing company, Vitro, S.A.B. de C.V. ("Vitro"), approved by the Federal District Court in Mexico, should be enforced under Chapter 15 of United States Bankruptcy Code.[26] The Bankruptcy Court concluded that the Concurso Plan should not be accorded comity to the extent that it extinguishes the guaranties held by the Debtor's non-debtor subsidiaries in favor of third-party noteholders. In the Bankruptcy Court's view, such an order would be manifestly contrary to the public policy of the United States. The Bankruptcy Court's opinion joins a very short list of cases that address the public policy exception under section 1506 of the Bankruptcy Code.

Case Background

The Concurso Plan, as originally proposed and ultimately approved in Mexico, eliminated any recourse certain noteholders held against Vitro's non-debtor subsidiaries. The noteholders were not pleased. Vitro then filed a petition in the United States seeking recognition of the Mexican reorganization case as a foreign main proceeding under Chapter 15 of the Bankruptcy Code. Recognition was granted on July 21, 2011.

In August 2011, a group of noteholders filed suit in New York state court against the subsidiaries. The New York court ruled in favor of the noteholders, finding that the indentures prevented non-consensual modification of the subsidiaries' guaranties because the subsidiaries expressly waived any rights under Mexican law.

The Mexican court approved the Concurso Plan on February 3, 2012, and Vitro proceeded to consummate the plan, issuing new notes and debentures, effectively discharging the obligations of Vitro's non-debtor subsidiaries, and funding trusts for the payment of claims. Approval of the Concurso Plan discharged Vitro's obligations to the noteholders under the original notes and released claims against the subsidiaries under the guaranties. Vitro then filed its motion to enforce the Concurso Plan in the United States and sought a permanent injunction of collection efforts against its subsidiaries pursuant to sections 105, 1507, and 1521 of the Bankruptcy Code. Certain noteholders filed objections to the enforcement motion (the "Objecting Parties").

[26] *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).

The Bankruptcy Court's Conclusions

The Bankruptcy Code does not define "manifestly contrary to public policy" but the public policy exception of section 1506 of the Bankruptcy Code is meant to be narrowly construed and used only to defend the most fundamental policies of the United States. The courts primarily focus on two factors:

> (1) whether the foreign proceeding was procedurally unfair; and (2) 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 U.S. statutory or constitutional right, such that granting comity would "severely hinder United States bankruptcy courts' abilities to carry out . . . the most fundamental policies and purposes of these rights."[27]

The Bankruptcy Court rejected the arguments of the Objecting Parties regarding corruption of the Mexican judiciary, impact on the credit markets from approval of the Concurso Plan, and general unfairness of the Mexican proceedings and noted that these objections would more appropriately be handled by the Mexican courts, noting that an appeal of the Concurso had already been filed in Mexico.

The Bankruptcy Court recognized that the United States has a general policy against the discharge of entities other than a debtor in an insolvency proceeding and denied the enforcement motion for three reasons. First, the Concurso Plan does not substantially comply with the distribution scheme prescribed by the Bankruptcy Code. Under the Bankruptcy Code, the Objecting Parties would receive distributions from Vitro and also be able to recover any deficiencies from the non-debtor subsidiary guarantors. The Concurso Plan, however, provides for drastically smaller recoveries and extinguishes guarantor liability. Second, the Concurso Plan does not sufficiently protect creditors' interests as required by section 1521(a) in a manner that is balanced with the interests of Vitro. Third, protection of third party claims in a bankruptcy case is a fundamental policy of the United States, and because the Concurso Plan extinguishes these claims, it is manifestly contrary to that public policy and is unenforceable.

The Bankruptcy Court also noted, but did not rule on, two other "meritorious" arguments of the Objecting Parties. Insiders, including intercompany claims, were allowed to vote on the Concurso Plan even though bonds were issued shortly before the Concurso proceeding under questionable circumstances. Also, the Concurso Plan arguably violated the absolute priority rule because the holders of equity in Vitro retained significant value when the creditors were not paid in full.

The Bankruptcy Court stated that generally, the Concurso Plan would be enforced in the United States; however, the Vitro plan was unenforceable. The Bankruptcy Court stayed its decision until June 29, 2012 to allow Vitro an opportunity to appeal the Bankruptcy Court's decision and seek a stay on appeal. Vitro filed a request for a direct appeal to the Fifth Circuit

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[27] *In re Ephedra Prods. Liab. Litig.*, 349 B.R. 333, 336 (S.D.N.Y. 2006) (quoting *Micron Tech., Inc. v. Qimonda AG* (*In re Qimonda AG Bankr. Litig.)*, 433 B.R. 547, 568–69 (E.D. Va. 2010)) (citations omitted).

pursuant to 11 U.S.C. § 158(d), and the Bankruptcy Court granted Vitro's request on June 21, 2012.

The Fifth Circuit Ruling[28]

On November 28, 2012, the Fifth Circuit Court of Appeals (the "Fifth Circuit") affirmed the order of the Bankruptcy Court. After determining that the foreign representatives were properly appointed and that the Chapter 15 case was valid, the Fifth Circuit concluded that although, in exceptional circumstances, Chapter 15 relief may include enforcing a foreign court's order extinguishing the obligations of non-debtor guarantors, Vitro had failed to demonstrate that such relief was appropriate. The Court recognized that comity is a principal objective of Chapter 15. In considering whether to grant relief, the Fifth Circuit noted that it is not necessary that the result achieved in the foreign bankruptcy proceeding be identical to that which would be had in the United States. It is sufficient if the result is comparable. Nevertheless, the Fifth Circuit concluded that the Concurso Plan manifestly contravened the public policy of the United States and was precluded from enforcement under sections 1507, 1521, and 1522 of the Bankruptcy Code. Only if the relief requested by the foreign representative is not among those specifically listed in section 1521 of the Bankruptcy Code or "appropriate relief" under section 1521(a) of the Bankruptcy Code (relief previously provided under former section 304) should a court consider whether "additional assistance" should be provided under section 1507 of the Bankruptcy Code. Relief under section 1507 of the Bankruptcy Code is in nature more extraordinary than that provided under section 1521 of the Bankruptcy Code and, as a result, the test for granting that relief is more rigorous. While the broad grant of assistance of section 1507 of the Bankruptcy Code is intended to be a "catch all" it cannot be used to circumvent restrictions present in other parts of Chapter 15, nor to provide relief otherwise available under other provisions.

After concluding that the relief requested by Vitro for what amounted to a third party injunction preventing actions against its non-debtor subsidiaries was neither enumerated in section 1521 of the Bankruptcy Code nor "appropriate relief" under sections 1521(a) and 1522 of the Bankruptcy Code (which requires a balancing of the interests of creditors and debtors), the Fifth Circuit examined whether "additional assistance" should be provided under section 1507 of the Bankruptcy Code. The Fifth Circuit determined that section 1507 of the Bankruptcy Code does theoretically provide for a non-consensual, non-debtor injunction and release but such relief would not be available in the Fifth Circuit. However, even though such relief would be available in other circuits, Vitro had not shown the extraordinary circumstances that would make enforcement of the Vitro plan appropriate in the United States. After quoting cases describing the circumstances justifying non-debtor releases as "unique" and "dramatic," the Fifth Circuit noted seven factors listed in prior cases:

> (1) There is an identity of interests between the debtor and the third party, usually an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate; (2) The non-debtor has contributed substantial assets to the reorganization; (3) The injunction is essential to reorganization, namely the reorganization hinges on the debtor being

[28] *Vitro II,* 701 F.3d 1031 (5th Cir. 2012).

> free from indirect suits against parties who would have indemnity or contribution claims against the debtor; (4) The impacted class, or classes, has overwhelmingly voted to accept the plan; (5) The plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction; (6) The plan provides an opportunity for those claimants who choose not to settle to recover in full and; (7) The bankruptcy court made a record of specific factual findings that support its conclusions.

Because the Concurso Plan did not comply with many of the factors that would justify a non-debtor release in the United States, the Court concluded that relief under section 1507 of the Bankruptcy Code should be denied. While the equity interests in Vitro retained hundreds of millions of dollars of value, the creditors' recovery was estimated at forty cents on the dollar. All unsecured creditors, including intercompany claims, voted in a single class and the majority of the objecting creditors voted against the plan. Because the Fifth Circuit determined that the Concurso Pan was not enforceable under sections 1507 and 1521 of the Bankruptcy Code, it did not reach the issue of whether the plan was manifestly contrary to the public policy of the United States under section 1506 of the Bankruptcy Code.

Other Vitro Court Battles

On August 28, 2012, the United States District Court for the Northern District of Texas (the "District Court") overturned the Bankruptcy Court on appeal and ruled that certain subsidiaries of Vitro should have been placed into bankruptcy involuntarily. The Bankruptcy Court originally denied the involuntary petitions finding that the debts owed by the subsidiaries were only contingent debts because the notice to pay had not been provided to the subsidiaries, and finding that the subsidiaries were generally paying their debts as they became due. The District Court disagreed on both points.

The subsidiaries' payment obligations on the guaranties, represented by notes governed by indentures, were not contingent because the indentures waived the demand requirement; therefore, demand for payment was not a precondition to payment on the notes. Additionally, although the subsidiaries were paying trade debts as they came due, the trade debts only represented 0.1% of the subsidiaries unsecured debt—the notes accounted for the other 99.9% of the subsidiaries' debt. So, when considering the totality of the circumstances, while the subsidiaries may have been generally paying debts in terms of the number of creditors being paid, the subsidiaries were not generally paying their debts in terms of the amount owed.

The District Court vacated the Bankruptcy Court's orders on these matters and remanded the case for further proceedings.

Vitro Settlement

On March 14, 2013, the Bankruptcy Court entered orders in the Vitro Chapter 15 case (and the related Chapter 7 and Chapter 11 cases) authorizing and approving certain settlements and broad mutual releases between the Vitro noteholders, Vitro and its direct and indirect

subsidiaries, and other interested parties to end all litigation in Mexico and the United States.[29] On April 8, 2013, the settlement closed in accordance with its terms.[30] In addition to providing for broad mutual releases and the dismissal of all pending suits, actions, appeals, and *amparos*, the settlement provides that Fintech Advisory Ltd., an investment company, will purchase all of the noteholders' bonds for 85.25% of their principal amount and pay the indenture trustee and the noteholders an additional aggregate amount of $57.5 million for fees, costs and expenses incurred in part in connection with the bankruptcy proceedings.[31]

Elpida Memory, Inc.

Coincidentally, one of the objectors in *Qimonda*, Elpida Memory, Inc. ("Elpida"), filed for reorganization in Japan. The Elpida foreign representatives then filed a Chapter 15 case in the United States Bankruptcy Court for the District of Delaware and sought an order approving the sale and licensing of certain U.S. assets.[32] The proposed transactions had been approved by the Japanese reorganization court. Bankruptcy Judge Sontchi looked to section 1520(a)(2) of the Bankruptcy Code, which applies section 363 to a Chapter 15 case *the same extent that the section would apply to property of the estate*. The foreign representatives argued that comity requires the court to approve the transactions unless such approval would be manifestly contrary to the public policy of the United States under section 1506 of the Bankruptcy Code. After reviewing several sections of Chapter 15, which provide the court with broad discretion to grant any appropriate relief, Judge Sontchi read the plain meaning of section 1520(a)(2) of the Bankruptcy Code to require the court to review the transactions *de novo* as it related to assets in the United States and, in so doing, apply the well settled standard governing a sale of assets under section 363 of the Bankruptcy Code. After a subsequent evidentiary hearing the transactions were approved.

Fairfield Sentry Limited[33]

Although ultimately overruled, Judge Lifland came to a different conclusion in the *Fairfield Sentry* case where the foreign representative of a BVI feeder fund (Sentry) sought a full section 363 review of a sale by the BVI debtor of a $230 million claim in the Bernie Madoff bankruptcy. Unfortunately for the BVI debtor, it had agreed to sell its Madoff claim at a discount to a buyer days before the Madoff trustee negotiated a $5 billion settlement with a third

[29] *See* Order Approving Joint Emergency Motion of Chapter 7 Trustee, Chapter 11 Debtors, Vitro S.A.B. de C.V., and Vitro Packaging de México S.A. de C.V, Pursuant to Federal Rule of Bankruptcy Procedure 9019 and Bankruptcy Code Section 363, for Entry of an Order Approving Compromise and Settlement, Case No. 11-33335-hdh-15 (Mar. 14, 2013) [Docket 547].

[30] *See* Disclosure by Alejandro Francisco Sánchez Mújica, as Co-Foreign Representative of Vitro, S.A.B. de C.V. Pursuant to 11 U.S.C. § 1518 Regarding Settlement, Case No. 11-33335-hdh-15 (Apr. 8, 2013) [Docket 554].

[31] *See* Joint Emergency Motion of Chapter 7 Trustee, Chapter 11 Debtors, Vitro S.A.B. de C.V., and Vitro Packaging de México S.A. de C.V, Pursuant to Federal Rule of Bankruptcy Procedure 9019 and Bankruptcy Code Section 363, for Entry of an Order Approving Compromise and Settlement, Case No. 11-33335-hdh-15 (Mar. 1, 2013) [Docket 538].

[32] *In re Elpida Memory, Inc.*, Case No. 12-10947, 2012 WL 6090194 (Bankr. D. Del. Nov. 20, 2012) (correcting and superseding earlier opinion).

[33] *In re Fairfield Sentry Ltd.*, 484 B.R. 615 (Bankr. S.D.N.Y 2013).

party that approximately doubled the value of the Madoff claims. The sale was subject to approval by both the BVI court and the Madoff bankruptcy court where the Sentry Chapter 15 had been filed. The BVI debtor was then party to a three day BVI hearing that confirmed the sale. Notwithstanding the BVI ruling, the foreign representative contended that Judge Lifland should conduct a full section 363 review of the sale. Judge Lifland declined, holding that the Madoff claim was an asset of the BVI debtor and that its sale did not involve a transfer of an interest of the debtor in property within the territorial jurisdiction of the United States, as is required by section 1520(a)(2) of the Bankruptcy Code. In coming to his conclusion that an independent section 363 analysis was required, Judge Lifland noted that in *Vitro* comity was elevated to a "principal objective" while the *Elpida* court found comity "not the end all and be all of the statute." Finding no meaningful interest in the disposition of the claim of the BVI debtor Judge Lifland exercised comity, enforced the determination of the BVI court and denied the relief requested by the foreign representative.

On appeal, the Court of Appeals for the Second Circuit (the "Second Circuit") vacated Judge Lifland's ruling and remanded for a section 363 review.[34] The Second Circuit found that the Madoff claim was a transfer of interest of the debtor's property within the meaning of section 1520(a)(2) of the Bankruptcy Code. Accordingly, the Second Circuit held that "the bankruptcy court was required to conduct a section 363 review [and that] [d]eference to the BVI court was not required."

On remand, Judge Stuart Bernstein granted the foreign representative the full section 363 review.[35] Ultimately, Judge Bernstein disapproved the sale of the Madoff claim based on the section 363 review. The foreign representative sought to disprove the sale because the Madoff claim had greatly increased in value. Specifically, the purchase price was originally approximately $73.9 million, but prior to consummation, the foreign representative had already received distributions under the Madoff claim of approximately $115 million. The bankruptcy court found that disapproving the sale was in the best interest of the estate and an exercise of sound business judgment because holding the claim would allow the foreign representative to sell it at a much higher price.

More Fairfield Sentry Limited[36]

In another *Fairfield Sentry* opinion, the Second Circuit concluded that the contention that the BVI proceedings for Fairfield Sentry were "cloaked in secrecy" was not enough to prevent recognition of the British Virgin Islands proceeding. The Second Circuit concluded that the manifestly contrary exception required a narrow reading, should be read "restrictively" and invoked only "under exceptional circumstances concerning matters of fundamental importance for the enacting state." While applications and orders were sealed in the BVI proceeding, summaries were available and any non-party could apply to the court for access to the sealed documents. In any event, the Second Circuit concluded that unfettered public access to court

[34] *In re Fairfield Sentry Ltd.*, 768 F.3d 239 (2d Cir. 2014).

[35] *In re Fairfield Sentry Ltd.*, 539 B.R. 658 (Bankr. S.D.N.Y. 2015).

[36] *In re Fairfield Sentry Ltd.*, 714 F.3d 127 (2d Cir. 2013).

records is not so fundamental in the United States as to constitute one of the exceptional circumstances contemplated by the manifestly contrary exception. The Court also concluded that the appropriate date to measure the center of main interest of a debtor is normally the date of the filing of a Chapter 15 petition but that the time between the filing of the foreign proceeding and the date of the Chapter 15 petition may be considered in determining whether manipulation of the COMI had occurred.

Ashapura Minechem Ltd

An interesting case involving the manifestly contrary concept of section 1506 of the Bankruptcy Code is *Ashapura Minechem Ltd*.[37] The debtor was involved in an Indian insolvency proceeding under a statute that had been repealed yet was still being utilized pending the adoption of a new statute. Although the repealed Indian statute had been criticized, Judge Peck granted recognition to the foreign representative and determined that the continued imposition of the automatic stay of section 1520 of the Bankruptcy Code would not be manifestly contrary to the public policy of the United States. Judge Peck's decision was affirmed by the District Court.[38] Subsequently, recognition was revoked and the Chapter 15 case was dismissed based upon the inability of the creditors with United States judgments against the debtor to fully participate in the Indian proceeding.

Gerova Financial Group, Ltd

In *Gerova Financial Group, Ltd.*, Judge Gropper granted recognition of a foreign representative of a debtor in a Bermuda liquidation proceeding over the objection of creditors who argued that recognition was manifestly contrary to public policy since recognition was "unnecessary."[39] The involuntary proceeding in Bermuda had been commenced by only one creditor and was against the wishes of most of the other creditors. None of these objections rose to the level of manifestly contrary to public policy as required by section 1506 of the Bankruptcy Code.

In re Sivec SRL[40]

In connection with a sale of parts by Sivec SRL ("Sivec") to Zeeco, 10% of the contract price was withheld by Zeeco to cover warranty claims for a two year period. Prior to the expiration of the warranty period, Sivec filed an insolvency proceeding in Italy. Since Sivec had not yet received any warranty claims, it listed a receivable from Zeeco and did not list Zeeco as a creditor. Consequently, Zeeco did not receive notice of the Italian insolvency proceeding. Ultimately the Sivec plan provided for a 34 cent payment to unsecured creditors and a 15 cent payment to late filed claims. Sivec then demanded that Zeeco pay the warranty retainage since the two year warranty period had expired. Zeeco refused and filed suit in Oklahoma District Court seeking damages against Sivec for breach of contract and to keep the retainage. Sivec

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[37] *In re Ashapura Minechem Ltd.*, Case No. 11-14668, 2011 WL 5855475 (Bankr. S.D.N.Y. Nov. 22, 2011).

[38] *Armada (Singapore) PTE Ltd. v. Shah (In re Ashapura Minechem Ltd.),* 480 B.R. 129 (S.D.N.Y. 2012).

[39] *In re Gerova Financial Grp.*, Ltd., 482 B.R. 86 (Bankr. S.D.N.Y. 2012).

[40] *In re Sivec SRL*, 476 B.R. 310 (Bankr. E.D. Okla. 2012).

consented to jurisdiction and counterclaimed in the Oklahoma suit for the retainage. Just before the suit was to be tried, Sivec filed a Chapter 15 case in Bankruptcy Court in Oklahoma and sought a stay of the Oklahoma District Court suit. The Sivec foreign representative was granted recognition but the request for stay was denied, and the stay under section 1520 of the Bankruptcy Code was lifted to allow the Oklahoma District Court suit to proceed.

The jury in the Oklahoma District Court suit awarded Zeeco $1,744,043 on its breach of contract claim and Sivec €952,840 on its retainage claim. The Oklahoma District Court then sent the matter of offset claimed by Zeeco to the Bankruptcy Court. Sivec asked that the retainage funds be remitted to Italy and that the rights of offset claimed by Zeeco be determined in the Italian insolvency proceeding. Zeeco sought relief from the stay to exercise its rights of offset. The bankruptcy court noted that certain "requests for comity," purportedly from the Italian insolvency judge, had actually been prepared and submitted by counsel for Sivec. Additionally, it was determined that the Italian judge was only authorized to hear procedural matters in the Italian insolvency proceeding. In light of the lack of candor of the foreign representative, the fact that Zeeco had not received notice of the Italian insolvency proceeding, the failure of Sivec to provide information regarding the status of the Italian insolvency proceeding, and the failure of Sivec to demonstrate a procedure in the Italian proceeding for Zeeco to assert its rights of setoff and recoupment, the bankruptcy court concluded that granting the request of Sivec would be manifestly contrary to the public policy of the United States because the rights of Zeeco had not, and would not, be protected in the Italian proceeding. The bankruptcy court declined to grant comity to the Italian proceeding and lifted the stay to allow Zeeco to recoup and offset its claims against the retainage.

Collins v Oilsands Quest, Inc.[41]

In the *Collins* case, the United States District Court for the Southern District of New York concluded that the enforcement of a *temporary* stay order of a Canadian court staying actions against officers and directors of a company engaged in a Canadian insolvency proceeding was not manifestly contrary to the public policy of the United States. The court noted that the stay of proceedings for officers and directors is a standard feature of proceedings under the Canadian Companies' creditors Arrangement Act which has been routinely enforced in the United States. While acknowledging that the Canadian system was different than that of the United States, the court agreed to enforce the Canadian order since the question was not whether the court would have granted the stay had it been presented to the United States court but whether comity and deference should be accorded to the Canadian court. Although this decision was entered a month after *Vitro*, the *Vitro* case was not mentioned and can be distinguished on the basis that the relief sought in *Collins* was temporary while the debtor in *Vitro* sought enforcement of a permanent injunction.

Continued Uncertainty

Case law is sparse regarding the public policy exception of section 1506 of the Bankruptcy Code. The decisions in *Vitro* regarding the dischargeability of third-party claims and in *Qimonda* regarding intellectual property rights will be closely examined in light of the

[41] *Collins v. Oilsands Quest Inc.*, 484 B.R. 593 (S.D.N.Y. 2012)

availability of third party injunctions in U.S. Chapter 11 cases and developments in intellectual property practice. Until the dust settles and case law is further developed, the limits of assistance that United States courts will provide under Chapter 15 will remain debatable.

Conclusion

Mexico's proximity to the United States and its resurgent economy make Mexican companies and customers attractive for many American businesses. For companies conducting business transactions in Mexico, it is vital to understand what rights and obligations exist in the event of default or counterparty insolvency. Mexico and the United States' adoption of UNCITRAL's Model Law on Cross-Border Insolvency provide an effective mechanism to protect debtors and creditors on an international scale. As more case law develops on the application of Chapter 15's provisions, practitioners should stay up-to-date on the latest trends to ensure their interests remain protected.