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NEWS

INSIDE TRACK: CLEARY'S RICHARD COOPER ON VITRO

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When Mexico's largest glassmaker, Vitro, was forced to declare voluntary insolvency after defaulting on bond payments in 2009, few could have predicted that the case would become one of the most important bankruptcy hearings in the country's history and question the very basis of judicial independence enshrined in Chapter 15 of bankruptcy legislation passed by the US four years earlier.

After Vitro won approval for its pre-packaged bankruptcy plan in Mexico, it expected the US to simply rubber stamp the deal and bring to an end what was already becoming a costly litigation. But the US Bankruptcy Court subsequently refused to enforce the plan – a decision that threatened to spark a diplomatic row between the US and Mexico and risked undermining the entire concept of judicial independence enshrined by both countries. Lawyers on the case found themselves in unchartered territory, forced to drawn on past experience and conjure up innovative legal solutions to close the deal.

Last week, all sides achieved what even a few months earlier seemed an impossibility, as Vitro reached a settlement with its dissenting bondholders and brought an end to four years of highly contested litigation. With the dust now beginning to settle, Joe Rowley speaks to Cleary Gottlieb Steen & Hamilton LLP's Richard Cooper about his role in helping Fintech, Vitro's largest creditor, bring the various sides to a final settlement and the impact the case is likely to have on Mexican and other foreign bankruptcy cases that end up being litigated in US courts.

Latin Lawyer: For many following the Vitro case, it would probably not be too much of an exaggeration to describe last week's settlement as a historic day for the way bankruptcy cases are handled between the US and Mexican courts, as well as a litmus test of the judicial relations between the two countries. Before we move on to discuss the settlement and your role in reaching it, tell me how you became involved in the case and your role in it?

We actually started off working for a group of financial institutions that had entered into derivatives with Vitro that were in default and that was even before Vitro defaulted on its bonds. After counselling them regarding termination, set off and other bankruptcy related issues, we represented the group in early discussions regarding a possible restructuring of Vitro. Each of the institutions had retained their own individual counsel to litigate against Vitro in the US so we were the group's "restructuring" lawyers. More than a year later, when little progress had been made between our group of creditors (or, for that matter, the company's other major creditors - its bondholders) and Vitro, the group disbanded and all but one of the institutions sold their claims to Fintech. Thereafter we started representing Fintech. Our role initially was to help negotiate a restructuring plan with Vitro that would be the basis for a solicitation and exchange offer by Vitro to its bondholders. At the time Fintech was the largest creditor and when the offer was launched Fintech entered into a lock-up agreement and offered to purchase a portion of the outstanding bonds for cash, so we helped Fintech with those things as well. Before and after the offer was launched Vitro, Fintech and an ad hoc group of bondholders were in discussions to see if they could come to a negotiated deal. Unfortunately, although the parties were not very far apart, they did not reach a deal and the composition of the ad hoc committee changed and the determination was made by the group to litigate. This led to a prolonged and contentious period of litigation which involved proceedings in Texas, New York and Mexico, where we were also directly involved. Finally, and most recently, we were involved in helping the parties reach a settlement. So, yes we were heavily involved in the case from the beginning to the end.

LL: Many of the issues in the Vitro case were without precedent and could have far-reaching consequences. How did you approach these challenges and what previous cases did you draw upon to assist you?

One of the early issues we had to deal with was what to do if the case was approved in Mexico, but not in the US, and dissenting bondholders sought to interrupt, or seek to attach payments, to consenting creditors. We have experience with this issue as a result of our sovereign practice and our work for bondholders in private sector restructurings. As part of the initial plan we took certain precautions and built in certain structural changes to make it less likely this could happen. One of the techniques we included in the plan to address this risk was to have Vitro issue debt securities to two local trusts and have those trusts issue credit linked notes to creditors. A few years ago, we were involved in a case in Argentina representing an ad hoc committee of bondholders involved in the Transportadora de Gas del Norte restructuring and we employed a similar strategy for different reasons. Another example of a precedent we utilised in the last few weeks, again in a different context, was the Comerci case because in that one our clients had litigated successfully in the US but were still interested in settling so we had similar issues of trying to manage both a litigation and settlement process at the same time. There were other cases that we have worked on that were of help, including some Mexican cases such as IUSA, where we represented an ad hoc bondholder group in a successful restructuring that was effected through a Chapter 11 proceeding, as well as some non-Mexican cases , such as Independência's judicial reorganisation, which had some novel Chapter 15 issues at the time.

LL: When negotiations broke down it led to a lengthy period of litigation between the parties involved. What were the most unusual legal features?

Vitro is the first Mexican case where a plan was passed in Mexico that was not enforced in the US, so it is unusual just in that aspect alone. In addition to that, the Fifth Circuit decision effectively created new law on how US bankruptcy courts should evaluate requests for relief in the US by foreign debtors. The court articulated a new analytical framework to consider these questions that essentially requires foreign debtors, and their approved plans, to meet the requirements of certain sections of the US bankruptcy code as if they were US debtors. This is the first court to articulate such a framework and to impose these requirements on issues that do not touch on due process, creditor discrimination or fundamental issues of US public policy.

LL: What impact will that have on other companies looking to enforce restructuring plans in the US?

Following the decision, the question that many foreign companies are going to face when they have a reorganisation plan approved in their home jurisdiction is do they want to seek to enforce that plan in the US, taking the risk that they may need to re-litigate the entire case there, or do they not seek to enforce it and hope for the best if they have assets or interests in the US. The answer will depend on the facts in each case and also whether they would find themselves in the Fifth Circuit. It is far from clear that other courts will follow the Fifth Circuit decision and even the analytical framework it set out. The facts in the Vitro case were quite unique, and the issue that the Fifth Circuit focused on – whether a US court should enforce a release of a non-debtor party contained in a foreign law approved plan of reorganisation – was not as broad as most people believe when they refer to the Vitro decision. The Fifth Circuit has historically had clear views on this narrow legal issue and has said it would not enforce such releases in the context of a US debtor's plan of reorganisation. Other circuit courts have taken a different view on this subject, so it is not clear that the Fifth Circuit decision will be followed widely, if at all. But it is certainly the law in the Fifth Circuit today.

LL: What is your personal view?

I think it was the wrong decision because it didn't give enough deference to the foreign proceeding and comity is the overriding and paramount principal behind Chapter 15. The ruling effectively says to a foreign debtor that not only does the foreign debtor's plan have to work as a matter of local law, but if the company wants US courts to enforce the plan it has to meet the criteria that apply to US companies going through a Chapter 11 case. While this would certainly be understandable, indeed necessary, if there had been a denial of due process, evidence of discrimination against US creditors or other violation of fundamental US public policies, that was not what the court found here. Obviously, bad facts make bad law and the facts as presented in this case undoubtedly influenced the court. I worry, a bit, whether some foreign companies will stop providing subsidiary guarantees or end up filing locally reorganisation plans for their operating subsidiaries which, a least in Mexico, presents certain challenges.

LL: With the benefit of hindsight, is there anything you or the parties would or should have done differently?

I think there were a lot of things that could have been done differently. As I mentioned, there was a point before Vitro filed its initial concurso plan and before the change in the composition of the ad hoc creditor committee that the parties were not that far apart. In hindsight it is a shame the parties were not able to bridge their differences then. Another thing that was unfortunate was the absence of communication among the parties during the case. One of the things this case shows is that once you commence litigation it is sometimes very hard to dial it back particularly if the only communication is among the litigators running the show. There was virtually no discussion among the various parties while they were litigating, which is unusual at least in emerging markets restructurings. For most restructuring deals in Latin America there isn't litigation to begin with, but even when there is, usually the parties maintain some sort of dialogue. Litigation is viewed as a tactic that may lead to a better recovery, not as an end in, and of, itself. In this case, there was no dialogue. No doubt that had to do with some of the players involved here and the circumstances of this case. But it meant that each side was making assumptions without any basis about the other side's potential willingness to compromise. But in fairness, once you start litigation, and particularly an aggressive litigation on both sides, it is often hard to step back.

LL: If the parties were close to an agreement before Vitro filed its initial restructuring plan, what led to such divergent views further down the line?

In many respects, the differences stemmed from the divergent views each of the parties had about what the legal outcome would be. I am sure the ad hoc committee thought they would stop the process in Mexico and the plan wouldn't be approved. When it was approved, they were very confident that the courts in the US wouldn't enforce the plan. Conversely, the company was confident they would have the plan approved in Mexico, which it was, and confident the courts in the US would enforce it, and they were wrong. Each was 50 per cent right.

LL: How does the Mexican restructuring process differ to restructurings in the US?

The fundamental difference between the Mexican insolvency regime and a US Chapter 11 process is that in the US creditors can impose a plan on the company and its equity holders, whereas in Mexico creditors can't impose a plan on the company and its shareholders. It is a fundamental difference and leaves creditors in a situation where they can either negotiate a plan with the company that is almost certainly going to be more shareholder friendly than they are used to, or seek to liquidate the company, which is not only challenging and risky but value destructive for all. There are many other differences, but in some sense that is the most important.

LL: With these challenges in mind, how did you manage to reach a final settlement and what type of legal work was required?

Ultimately the settlement wouldn't have been possible unless someone came forward to buy the claims of the ad hoc group for cash. Neither party wanted to have a continuing role with the other. As a result the key feature of the settlement was Fintech stepping in and purchasing the claims at an agreed cash price, agreeing with the company on the terms of ending the litigation and submitting the claims to the Mexican process. One of the challenges was how to implement the plan in various courts in Mexico and the US simultaneously, as well as coordinating various activities – the exchange of the bonds, funding the cash, dealing with the trustees and unaccounted for notes – in a simultaneous and coordinated way. Once the deal was struck, it took several weeks to document it, but fundamentally the primary issue was ensuring that each party could walk away clean and without any lingering litigation or risk. In the US there are certain ways to do that when you have pending litigation and even judgments. In Mexico it is not as straightforward and we spent a lot of time and effort trying to get everyone comfortable that it was achievable.

LL: With a settlement now reached in the Vitro case, how do you see bankruptcy and restructuring procedures developing in the coming years? Do you think creditors will become more reassured as these processes become more sophisticated, or do you think new structures will have to be introduced?

You'll see some improvements in the process in Mexico and other Latin American markets as time goes on. The situation in Brazil, for example, is much less creditor friendly than Mexico, and I don't think the market has focused on that yet, though they will. But as access to the international financial markets becomes more and more important to a wider group of Latin American companies, the law and the process will improve, but it will take time and it will be incremental. When we represented the banks in the Cemex restructuring last year, the market required that we include a voting trust for those claims even though no one really was worried that Cemex would file for concurso or even utilise that strategy. We have seen this in other new money deals as well. Previously, this technique was utilised only for restructured credits. It may take some time, but the market eventually reacts. Of course, international investors aren't naïve and they know, or at least should know, that when it comes to a default they aren't exactly in Kansas. There is a reason those yields are what they are.