Business Law Section Spring Meeting

Insolvency and the Multinational Enterprise

UNCITRAL Model Law and Chapter 15

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Introduction

- Insolvency and restructuring matters involving assets and operations in multiple jurisdictions can present practical and legal obstacles to the implementation of any effective restructuring solution.

- Debtors, creditors, and other parties benefit from **consistent, cohesive systems and processes** to deal with and harmonize multinational restructurings.

- This panel will discuss the legal, policy, and practical issues raised by restructuring a global enterprise, including:
  - conflicting priority schemes,
  - extraterritorial application of domestic laws, and
  - coordination of proceedings.

- This companion presentation provides information on one tool developed to address cross-border restructuring issues: the **UNCITRAL Model Law on Cross-Border Insolvency**, substantially adopted by the U.S. as **chapter 15 of the United States Bankruptcy Code**.
The UNCITRAL Model Law on Cross-Border Insolvency was first proposed in 1997 in response to the increase in cross-border insolvencies.

- In the historical absence of a unified, international regime, a variety of techniques developed to deal with cross-border insolvencies.
- Globalized trade and investment makes imperative a cohesive system for addressing cross-border issues.

The Model Law is designed to make recognition of a debtor’s foreign insolvency proceeding as simple, fast, and inexpensive for parties as possible.

- Recognition of a debtor’s foreign insolvency proceeding is not the only way to address multinational restructurings and does not offer a solution for every cross-border issue (e.g., restructuring including multiple entities in multiple jurisdictions).
- In many cases, though, recognition and coordination between or among different courts and professionals in different jurisdictions is key to resolving complicated cross-border questions.
- The bankruptcy and insolvency of Nortel Networks, Inc., for instance, included main proceedings and recognition proceedings in jurisdictions in the U.S., Canada, and the U.K.
Model Law Overview

Objectives of Model Law

- Rather than seeking to impose uniformity in substantive law, the Model Law provides flexibility.
  - **Drafted as model legislation.** Provides more flexibility than treaties or conventions.
  - **Limits new legal terminology.** Avoids internal inconsistencies with adopting state’s regime.
  - **Permits courts to tailor relief to local law as appropriate.** Offers option of conditioning or conforming relief available in recognition proceeding to comparable local proceeding.
  - **Remains subject to jurisdiction’s own law.** Permits jurisdictions to continue to adhere to own rules on the protection of local creditors and others (including debtors) and procedural and notice requirements.

  ➢ **The Model Law pays particular deference to a jurisdiction’s public policy.** Under the Model Law, public policy may limit or alter the consequences of recognition of foreign proceedings and/or a court’s authority to grant discretionary relief.

    ➢ See 11 U.S.C. § 1506 ("Nothing 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.")
Model Law Overview

Objectives of Model Law

- The Model Law seeks to *strike a balance* between international comity and respect for international differences.
  - The Model Law’s primary objective is to provide “a modern, harmonized and fair framework to address more effectively instances of cross-border insolvency.” 
    [UNCITRAL Model Law Guide to Enactment at 307](#).
  - At the same time, the Model Law “respects the differences among national procedural laws and does not attempt a substantive unification of insolvency law.” 
    [Id.](#)
- While providing for appropriate deference to a state’s *substantive* law, the Model Law accomplishes *four procedural objectives*:
  1. Promotes international *cooperation* between judges in cross-border cases
  2. Provides expedited and direct *access to the courts* for debtors (or their representatives) and creditors
  3. Creates framework for *recognition* of foreign proceedings
  4. Permits *concurrent* insolvency proceedings initiated domestically
Objectives of Model Law

- The Model Law helps provide *general legal certainty* around the administration and treatment of cross-border insolvency proceedings.
  
  > *Increased certainty helps to protect debtors’ businesses and estates (and, accordingly, creditors’ claims and investments) and promotes value-maximizing restructurings.*
  
- Nonetheless, conflicts between different jurisdictions’ substantive law can cause “growing pains” that undermine the general certainty promoted by the Model Law and make recognition and enforcement of insolvency proceedings in another jurisdiction difficult.
  
- Addressing these “growing pains” and developing ways of dealing with conflicts is critical for the Model Law to effectively harmonize cross-border insolvency proceedings.
  
- Moreover, to be successful, the Model Law must be widely adopted.
  
  > *Level of adoption to date means that debtors and creditors may not be able to count on the Model Law’s being available in all applicable jurisdictions the event of a later restructuring or insolvency.*
Model Law Overview

Worldwide Adoptions to Date

- Since its proposal in 1997, the Model Law has been adopted in only **42** jurisdictions (of a possible **193** members of the United Nations) around the world.

|------------------|---------------------------------|----------------------|---------------|------------------|---------------|----------------|

- The Model Law has **not** been adopted by a majority of G-20 countries or by the European Union (or a majority of EU member countries).

- The **EU Regulation on Insolvency Proceedings 2000** predates the Model Law and provides for similar recognition proceedings, but only with respect to EU member states.
Adoption of Model Law

Recent UNCITRAL Initiatives

- UNCITRAL Working Group V (Insolvency Law) continues to review and work on issues related to the Model Law and cross-border insolvency generally.

- Among other things, the Working Group has examined the legal treatment of cross-border insolvencies of multinational enterprise groups.
  - The existing Model Law provides for recognition proceedings on an entity-by-entity basis, with no special treatment of corporate families consisting of multiple entities in one or multiple jurisdictions.
  - The Working Group may consider new provisions for or a supplement to the Model Law that could extend certain provisions to corporate affiliates or other enterprise group members.

- The Working Group met most recently in December 2015. Its work and any changes or supplements to the Model Law remain in progress.
Adoption of Model Law

Recent UNCITRAL Initiatives

- The Working Group is engaged in designing a proposal for a unified system designed to handle multiple insolvency proceedings for multiple entities in multiple jurisdictions.

- The Working Group has identified eight key principles of any regime to address multinational enterprise group insolvencies or restructurings.

  1. Insolvency proceedings *need not be* commenced for every member of an enterprise group.

  2. A group solution will require *coordination* between or among group members and may require *coordinated proceedings* in multiple jurisdictions.

  3. One insolvency proceeding may be designated as the *main coordinating proceeding* (which may be a proceeding in the center of main interests\(^1\) of at least one group member necessary and integral to the group solution).

  4. An insolvency representative in one jurisdiction may need to be *authorized to participate in proceedings in other jurisdictions*.

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\(^1\) Under the Model Law, the center of main interests (“COMI”) determines which jurisdiction’s proceeding is the “main” proceeding for a particular entity.
Adoption of Model Law

Recent UNCITRAL Initiatives

- The Working Group has identified eight key principles of any regime to address multinational enterprise group insolvencies or restructurings (cont’d).

5. Participation in the main coordinating proceeding should be voluntary for group members with a center of main interests outside that proceeding’s jurisdiction.

6. Creditors and other stakeholders participating in a group solution should vote in their own jurisdiction according to applicable domestic law.

7. Following approval of a group restructuring, courts in all group members’ centers of main interests should have jurisdiction to implement the restructuring.

8. The insolvency representative in the main coordinating proceeding should have the right to access and participate in the courts in all group members’ centers of main interests to be heard on matters related to implementation of a restructuring.

Chapter 15 of the U.S. Bankruptcy Code

U.S. Adoption of the Model Law

- In 2005, the U.S. Congress considered and adopted the Model Law (with certain modifications) as chapter 15 of the U.S. Bankruptcy Code.

- U.S. adoption of the Model Law was motivated by the same factors that inspired UNCITRAL’s promotion of the Model Law in the first place:
  - encouraging cooperation between the U.S. and foreign countries with respect to transnational insolvency cases;
  - providing greater legal certainty for trade and investment as well as to provide for the fair and efficient administration of cross-border insolvencies; and
  - protecting and maximizing the value of the debtor’s assets.


- Similarly, in 2009, the Canadian federal legislature adopted new provisions (collectively, the “Canadian Law”) in the Companies’ Creditors Arrangement Act and the Bankruptcy and Insolvency Act that largely mirror the Model Law, subject to a few exceptions.
Chapter 15 of the U.S. Bankruptcy Code

Chapter 15 Filings by Year

- Since its adoption, chapter 15 has become a viable option for debtors seeking to implement their restructurings in the U.S.

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Public Policy Considerations

Three Seminal Cases Apply U.S. Substantive Law

- Chapter 15 provides access to the U.S. courts for foreign debtors and a forum and process to implement restructuring transactions.

- Because of conflicts between the goals of international comity and U.S. domestic policy, disputes over enforcement of relief granted by foreign courts have arisen (and will continue to arise).

- Three seminal chapter 15 cases resulted in opinions that squarely confronted such disputes.
Public Policy Considerations

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

- Vitro S.A.B. de C.V., a Mexican glass manufacturer, had approximately $1.2 billion in outstanding notes, which were guaranteed by substantially all of the Debtor’s subsidiaries.

- Vitro initiated a *concurso* proceeding in Mexico law in 2011 and later initiated a chapter 15 bankruptcy in the U.S.

- Vitro’s *concurso* plan provided that Vitro’s notes would be extinguished and the subsidiary guarantors’ obligations would be discharged (notwithstanding that the guarantors were not debtors in either the Mexican or the U.S. proceeding).

- The U.S. court held Vitro had not demonstrated circumstances that would allow the court to grant the non-debtor discharge under any U.S. bankruptcy law, and therefore it was not permitted under chapter 15.
Qimonda AG was a German semiconductor manufacturer. In January 2009, Qimonda filed for insolvency in Germany, and shortly after filed a chapter 15 petition in the U.S.

Qimonda’s German administrator requested recognition and other discretionary relief, including control over Qimonda’s U.S. assets (consisting almost entirely of U.S. patents).

- The bankruptcy court granted relief, but conditioned the administrator’s control on compliance with section 365(n) of the Bankruptcy Code, which restricts a debtor’s ability to reject intellectual property licenses without consent.

The appellate court determined that section 365(n) of the Bankruptcy Code outweighed contradictory German law.

Here, as in Vitro, the court gave great weight to a substantive aspect of U.S. bankruptcy law (protection of intellectual property licensees in Qimonda, restriction on non-consensual replacement of guarantees of non-debtors in Vitro).
Public Policy Considerations

In re Elpida Memory, Inc.

- Elpida, a leading maker of dynamic random access memory chips, filed for bankruptcy in Japan in February 2012 and, one month later, initiated a chapter 15 proceeding in the U.S.

- After a disposition of certain of Elpida’s assets (including U.S. assets consisting primarily of patents) had been approved by the Japanese court and the transactions consummated, the U.S. bankruptcy court determined that chapter 15 requires that any disposition of U.S. assets must satisfy the requirements for such dispositions in any other U.S. bankruptcy case.

- Ultimately, the U.S. court approved the sale under the applicable U.S. bankruptcy laws.
  
  - As with Vitro and Qimonda, the Elpida case indicates that courts, in practice, may apply substantive, local law before approving discretionary relief or recognizing orders entered in foreign proceedings.
Vitro, Qimonda, and Elpida show that substantive U.S. bankruptcy law has a significant role under chapter 15.

- U.S. courts may continue to apply substantive law from the U.S. Bankruptcy Code as a proxy for public policy, which may limit or alter the consequences of recognition and the court’s authority to grant discretionary relief.
- To the extent (if any) that courts in other nations take guidance from these decisions, this impact could be felt around the globe.

The decisions should help to develop chapter 15 jurisprudence and thereby enhance certainty—one of the primary goals of the Model Law.

- The questions at issue reflect the “growing pains” that are part of early application of many new laws by a jurisdiction’s courts.
- It is critical to develop consistent ways to deal with conflicts of substantive law for the Model Law to effectively harmonize cross-border insolvency proceedings.

Developing jurisprudence will increase certainty and help develop a more predictable cross-border insolvency regime—consistent with one of the primary objectives of the Model Law.
Appendix

Case Details
Case Details

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

- As of early 2011, Vitro S.A.B. de C.V., a Mexican glass manufacturer, had approximately $1.2 billion in outstanding notes, which were guaranteed by substantially all of the Debtor’s subsidiaries.

- Vitro initiated a *concurso* proceeding for reorganization under Mexican law on April 8, 2011.

- Later that year, before filing a restructuring plan in the *concurso*, Vitro also initiated a chapter 15 bankruptcy in the U.S.
  
  - The bankruptcy court subsequently entered an order recognizing the *concurso* as a foreign main proceeding and appointing Vitro’s requested foreign representatives under chapter 15, and an ad hoc group of noteholders appealed.
Later, in December 2011, a reorganization plan was proposed in the *concurso*.

- The plan provided that Vitro’s notes would be extinguished and the subsidiary guarantors’ obligations would be discharged (notwithstanding that the guarantors were not debtors in either the Mexican or the U.S. proceeding).
- All non-affiliated noteholders would receive new notes under the plan, which were economically much less favorable. The new notes were also guaranteed by the subsidiaries.

The *concurso* plan was approved and went effective in February 2012.

Vitro’s foreign representative then brought a motion in the chapter 15 case for an order enforcing the *concurso* plan in the U.S.

- Following a four-day trial, the bankruptcy court denied the motion, and Vitro appealed.

The Fifth Circuit then had before it two appeals from Vitro’s case:
- the Noteholders’ appeal of the order appointing the foreign representatives; and
- Vitro’s appeal of the order denying authority to enforce its *concurso* plan.
With respect to the appointment of the foreign representatives, the Noteholders raised two primary arguments.

1. **First**, they argued the foreign representatives did not meet the requirement of being “authorized in a foreign proceeding” because they had been selected by Vitro and not appointed by the Mexican court.

2. **Second**, they argued the foreign representatives did not have authority “to administer the reorganization or the liquidation of the debtor’s assets or affairs or to act as a representative of such foreign proceeding” based on Mexican insolvency law.

The Fifth Circuit rejected both arguments.

- The court held that the phrase “authorized in a foreign proceeding” requires only that the representative was appointed “in the context of, . . . during, or in the course of a foreign proceeding.”
- The court further held that the foreign representatives had the requisite administrative power over Vitro’s reorganization because they were appointed by Vitro, and Vitro retained sufficient control under Mexican law to be deemed to have authority to administer the reorganization.

The court drew heavily on UNCITRAL Working Group reports and the UNCITRAL Practice Guide for guidance on both arguments and relied on the flexible approach called for therein to determine these issues.
Case Details

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

- With respect to the enforcement of the concurso plan, the Fifth Circuit considered a narrow framing of the issue: “[w]hether the Bankruptcy Court erred as a matter of law when . . . it refused to enforce the [concurso] plan solely because the [c]oncurso plan novated guarantee obligations of non-debtor parties and replaced them with new obligations of substantially the same parties.”

- In the lower courts, the noteholders had also argued that certain other aspects of the concurso were improper—in particular, the application of a Mexican law provision allowing votes by insiders to count for purposes of approving a concurso plan.

- Ultimately, the court reached the following framework for evaluating the request for relief:

  1. First, a court should consider whether the relief requested falls under one of the explicit provisions of relief in section 1521 of the Bankruptcy Code.

  2. Second, if no specific provision of section 1521 applies, a court should decide whether it can be granted under the broader “appropriate relief” provision of section 1521(a). This, in turn, requires consideration of whether such relief was previously provided under section 304 and would otherwise be available in the United States.

  3. Third, if the requested relief does not fit those categories, a court should consider section 1507, which generally permits a court to provide “additional assistance to a foreign representative.”
This opinion creates a direct, substantive link between the availability of relief under chapter 15 and the availability of the same relief otherwise under the Bankruptcy Code.

• The framework is directly tied to whether the foreign representative would be able to obtain the requested relief under U.S. bankruptcy law.

Applying this framework to the case at hand, the court held:

1. the specifically enumerated relief in section 1521 did not apply to the requested relief;
2. the “appropriate relief” provision of section 1521(a) did not apply because Fifth Circuit precedent does not permit novation of non-debtor obligations under the Bankruptcy Code; and
3. the relief would be theoretically available to a chapter 15 debtor (notwithstanding Fifth Circuit bankruptcy law) under section 1507 because a non-debtor novation could be obtained elsewhere in the U.S., but Vitro had not demonstrated circumstances that would allow such relief even in the jurisdictions where it could be obtained.
In another much-anticipated decision, the Fourth Circuit considered whether discretionary relief (in this case, a foreign representative’s control over U.S. assets) may be conditioned on compliance with substantive U.S. bankruptcy law.

As with Vitro, the case hinged on whether international comity concerns were overcome by U.S. policy interests.

Qimonda AG was a German semiconductor manufacturer. In January 2009, Qimonda filed for insolvency in Germany, and shortly thereafter, the administrator overseeing Qimonda’s proceeding filed a petition for recognition and other discretionary relief, including control over Qimonda’s U.S. assets, under chapter 15.

At the same time (before any relief was granted by the bankruptcy court), the administrator sent letters to Qimonda’s licensees asserting that Qimonda’s patent licenses were no longer enforceable pursuant to German insolvency law.

The licensees objected to the requested relief and the assertion that the licenses could be rejected without their consent.

The bankruptcy court subsequently granted the request for relief, but conditioned the administrator’s control of Qimonda’s U.S. assets (consisting almost entirely of U.S. patents) on compliance with section 365(n) of the Bankruptcy Code, which restricts a debtor’s ability to reject intellectual property licenses without the consent of the licensee.

The administrator (now foreign representative) appealed.
The Fourth Circuit’s analysis focused on the provisions of section 1521 and 1522 of the Bankruptcy Code (which are based on Articles 21 and 22 of the Model Law).

- Discretionary relief under section 1521 is limited by section 1522. Relief is only available if “the interests of the creditors and other interested entities, including the debtor, are sufficiently protected,” and a court may restrict discretionary relief “to conditions it considers appropriate.”

- The Fourth Circuit held these provisions require “balancing the respective interests based on the relative harms and benefits in light of the circumstances presented, thus inherently calling for application of a balancing test.”

- As did the court in Vitro, the Fourth Circuit relied on UNCITRAL materials: here, the court drew on the UNCITRAL Guide to Enactment, including its statement that “there should be a balance between relief that may be granted to the foreign representative and the interests of the persons that may be affected by such relief.”
Applying its balancing test, the Fourth Circuit found the bankruptcy court’s determination that the licensees’ rights under section 365(n) outweighed the potential harm done to Qimonda was reasonable and affirmed.

- The bankruptcy court had found a substantial risk of harm to the licensees from patent infringement litigation and the possibility that terminating a licensee’s rights would introduce uncertainty into the semiconductor “patent thicket.”

- Qimonda’s administrator, on the other hand, could monetize the patents by licensing them and was only harmed in that he could not bring infringement suits against the licensees.

Here, as in Vitro, the court gives great weight to a substantive aspect of U.S. bankruptcy law (protection of intellectual property licensees in Qimonda, restriction on non-consensual replacement of guarantees of non-debtors in Vitro).
Elpida, a leading maker of dynamic random access memory chips, filed for bankruptcy in Japan in February 2012 and one month later initiated a chapter 15 proceeding in the U.S. Bankruptcy Court for the District of Delaware.

In the Japanese proceeding, Elpida sought and obtained approval for certain asset dispositions as part of its restructuring efforts, including transactions involving U.S. assets.

- After getting that approval, Elpida consummated the transactions, which consisted of a complex cross-licensing arrangement with Micron Technology, Inc. (which also purchased substantially all of Elpida’s assets) and a sale of 28 U.S. patents to competitor Rambus Inc.

A few months later, Elpida’s bondholders raised concerns that because the transactions undertaken by Elpida involved U.S. assets, approval by the U.S. bankruptcy court, in addition to the Japanese bankruptcy court, may have been necessary.

In response, Elpida sought approval of the transactions in its chapter 15 case.

- This request led to contention between Elpida and its bondholders over what standard the U.S. court should apply in evaluating the transactions.
Case Details

In re Elpida Memory, Inc.

- In making its request for approval, Elpida argued that chapter 15, and particularly the interests of comity, required that the U.S. bankruptcy court conduct only a limited review of the transactions, generally deferring to the judgment of the Japanese court.

- The bondholders responded that chapter 15’s express requirement that certain substantive U.S. bankruptcy laws apply to dispositions of U.S. property should control, notwithstanding the interests of comity.
  
  - Note: the Model Law itself (at Article 20) contemplates that local law restrictions on asset dispositions may be incorporated into the Model Law as enacted by a particular country.

- Ultimately, the U.S. bankruptcy court ruled that the standards of U.S. bankruptcy law would apply, *solely* with respect to the disposition of U.S. assets.
  
  - Applying those standards in a later decision, the U.S. bankruptcy court approved both of the transactions at issue.

- Elpida shows another way in which judges may utilize local insolvency law to re-evaluate the judgments made in foreign proceedings.