INSOL INTERNATIONAL

THE RESTRUCTURING OF CORPORATE GROUPS

A GLOBAL ANALYSIS OF SUBSTANTIVE, PROCEDURAL AND SYNTHETIC GROUP PROCEDURES

International Association of Restructuring,
Insolvency & Bankruptcy Professionals

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PRESIDENT'S INTRODUCTION

Rapid technological and digital change and innovation have enabled business to be conducted across borders, very often making use of complex corporate group structures with various group entities, assets and creditors located in different jurisdictions across the world.

In this business and economic setting, there has never been a greater need for a consistent, predictable and uniform international framework for recognition, coordination and enforcement in relation to cross-border restructuring processes for group enterprises.

This has become a key focus point for the United Nations Commission on International Trade Law (UNCITRAL) through the activities of its Working Group V (Insolvency). In July 2019, UNCITRAL released the Model Law on Enterprise Group Insolvency (MLEGI), designed to address the specific needs of cross-border restructuring and insolvency processes impacting multiple group members, as distinct from the Model Law on Cross-Border Insolvency (MLCBI) which only deals with the insolvency context of a single debtor. The MLEGI draws upon some of the features identified in the European Insolvency Regulation Recast, and is also intended to operate in conjunction with Part 3 of the UNCITRAL Legislative Guide on Insolvency Law dealing exclusively with the treatment of enterprise groups in insolvency.

The adoption and implementation of the MLEGI – along with the further uptake of the MLCBI – will be priority areas for UNCITRAL, INSOL International, the World Bank and other international insolvency regulatory and policy bodies in the years ahead.

However, in the interim – and given that no jurisdiction has yet adopted and implemented the MLEGI – it is important to understand and analyse the various approaches taken by different countries to corporate group restructuring involving entities, assets and creditors across borders. It is also important to consider the potential for cooperation through novel means such as synthetic restructuring, taking after the cross-border undertakings offered by the joint English administrators in the landmark case of *Re Collins & Aikman Europe SA* [2006] EWHC 1343.

This new publication from INSOL International – *The Restructuring of Corporate Groups: A Global Analysis of Substantive, Procedural and Synthetic Group Procedures* – does precisely that. It consists of 18 country contributions, as well as a chapter looking specifically at how Brexit will shape corporate group restructuring recognition and cooperation in the United Kingdom and the European Union in future years. Each chapter identifies the potential for substantive, procedural and synthetic restructuring processes and draws attention to key cases, legislative provisions and international treaties. There is also a focus on future policy development that may shape the potential for coordinated proceedings and cooperation.

This book is an invaluable contribution to law reform and regulatory and policy development in relation to the implementation of a harmonised, consistent approach to cross-border restructuring processes in a manner that enhances efficiency, reduces costs and increases the prospect of viable enterprises being able to undergo successful corporate and business restructuring in the interests of debtors and creditors alike. Importantly, those outcomes also provide a broader benefit to financial stability and economic growth at this critical juncture in our global history.

I express my sincere thank you to each of our contributors for their time, expertise, commitment and patience in completing this project over a number of years, as well as to our team of INSOL International technical and administrative staff for their efforts in bringing the project to fruition.

I hope you enjoy reading this publication and will find it useful in your future pursuits.

Scott Atkins
President & INSOL Fellow
INSOL International

June 2022

FOREWORD

This book is a special INSOL International publication which explores and evaluates the legal, economic and practical benefits of substantive and procedural consolidation of corporate group restructuring processes in 18 jurisdictions across the globe.

In countries where consolidated group restructuring proceedings are not yet available, the book also explores whether the use of so-called "synthetic" consolidated group proceedings would be admissible under local legislation and could result in similar benefits to actual consolidation for all stakeholders involved. Synthetic, in this sense, is a term used to describe measures put in place to obtain the same or a similar result without following the normal procedure.

In addition to the 18 country contributions, Professor Dr Stephan Madaus from the Martin Luther University Halle-Wittenberg has analysed, in a separate chapter, the impact that the United Kingdom's departure from the European Union (EU) as a result of Brexit may have on established practices concerning the restructuring of international corporate groups, and the future of the United Kingdom as a European hub for global group proceedings.

Empirical studies have shown that, when a company is part of a group, there is a reduced prospect of the company becoming bankrupt in the first place (primarily on the basis of the reallocation of resources and risks across companies in the group, and the increase of debt-bearing capacity and the reduced cost of debt through the provision of intra-group debt guarantees) compared to where entities exist on a standalone basis.[1]

Those same studies show that, if one or more companies in a group do in fact become bankrupt, then the ability to use consolidated group restructuring or bankruptcy procedures can also significantly reduce costs (as compared to using insolvency processes for each individual entity) and therefore increase the potential return to creditors.

In that context, consolidated group restructurings can offer significant economic benefits. In cases where substantive and / or procedural consolidation options are limited, synthetic processes can achieve similar outcomes.

In fact, those very outcomes were achieved on a synthetic basis in the *Collins & Aikman* case, a main proceeding in the United Kingdom that was led by one primary administrator without opening secondary proceedings in the different EU Member States, after making a commitment that creditors in the other EU Member States would be paid dividends in a priority according to their local insolvency laws. The *Collins & Aikman* case resulted in a higher return for all the creditors in the different EU Member States, as compared to what restructuring on the individual legal entity basis would have achieved.

1 N Dewaelheyns and Prof C Van Hulle, "Corporate Failure Prediction Modelling: Distorted by Business Groups' Internal Capital Markets?" (2006) *Journal of Business, Finance and Accounting*.

The *ratio legis* to this book was also meant to collect materials to support the proposal on consolidated group proceedings made by INSOL Europe on the Revision on the European Insolvency Regulation (EIR) in May 2012.[2] There, the idea was put forward that, regarding groups of companies, the centre of main interests (COMI) of the ultimate parent company ought to be deemed to be the COMI of the subsidiaries. The advantage would have been that, in the event of group insolvency, the court of the COMI would be able to safeguard the coordination of the main insolvency proceedings with respect to all the group companies and, secondly, the latter would in turn safeguard the application of the EIR then (the EIR Recast now) whenever the ultimate group COMI was located outside the EU.

My aspiration with this book is to provide an objective analysis of the current practices in different countries globally in relation to consolidated group restructuring and to make critical comments as to whether, even in the absence of legal options for substantive and procedural consolidated restructuring, synthetic legal group restructuring proceedings could be effectively used to achieve a more beneficial result than general coordination and cooperation procedures used in particular cases.

It is hoped that this book will be a valuable tool for practitioners, academics and the judiciary across the world and that the conclusions reached may serve as the basis for future law reform locally, regionally and globally.

This project would not have been possible without the help and support of many others. The initial acknowledgement must however go to the Technical Research Committee of INSOL International and Dr Sonali Abeyratne, Dr Kai Luck and Ms Waheeda Lafir in particular for all their assistance throughout the completion of the project, Ms Marie Selwood for the English language revision, and of course to all the chapter contributors to the book globally for their time, expertise and commitment. My final thanks go to Mr Neil Cooper, my mentor for over 30 years, who provided me with valuable insights in relation to the *Collins & Aikman* case and taught me to think out of the box and to always try and provide practical solutions to the benefit of all the stakeholders concerned in an insolvency or restructuring proceeding.

Nora Wouters
Dentons Europe LLP, Belgium

June 2022

[2] R Van Galen, M Andre, D Fritz, V Gladel, F Van Koppen, D Marks QC and N Wouters, "Revision of the European Insolvency Regulation", Proposal INSOL Europe, 2012, 92-93.

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AUSTRALIA

1. Consolidated group restructurings versus cooperation or coordination procedure

In Australia, restructurings can occur in the course of "formal" or "informal" processes.

In relation to formal restructures, these can occur pursuant to the processes outlined in Chapter 5 of the Corporations Act 2001 (Cth) (Corporations Act), namely schemes of arrangement, receiverships, voluntary administration followed by the execution of a deed of company arrangement (DOCA) and, in certain cases, liquidations. However, the key tools to achieve a restructuring within the formal processes are:

- DOCAs; and

- schemes of arrangement (members or creditors).

Further, with effect from 1 January 2021, a new formal restructuring process has applied in Australia under Part 5.3B of the Corporations Act. This process is known as a "small business restructuring" (SBR), and allows companies with total liabilities that do not exceed AUD $1 million to appoint a small business restructuring practitioner (while directors remain in control of the company) to work to develop a restructuring plan to submit to a vote of creditors. The SBR process is intended to be simple and more streamlined than proceeding under a DOCA. However, due to the eligibility limitation – so that a SBR can only be pursued by an eligible small business – the SBR process is unlikely to be relevant in a group restructuring context.

Where an insolvency practitioner (IP) takes on an appointment in relation to one of the above processes, it is to a specific corporate entity, as Australia strictly abides by the "separate legal entity" doctrine. There is nothing in Australian law that allows an IP to be appointed to a corporate group. However, in order to facilitate the administration of insolvent entities within a corporate group, or the restructuring of an enterprise group, the same IP is often appointed to each entity in the group. For example, a secured lender's security often extends to various entities within a corporate group, and a single receiver may be appointed to each of those entities within the group over which the lender has security (if there is a relevant default event). Similarly, if directors are considering an appointment to some or all entities within a corporate group (be it voluntary administration or winding up), they will often appoint the same IP to each member of the group to assist in cost savings and cooperation.

Notwithstanding that one IP has taken the appointment over each company within a corporate group, pursuant to the Corporations Act, he or she has to deal with each entity and its creditors separately (save for where a "pooling determination" is made, referred to below). However, the Corporations Act does provide scope for holding simultaneous meetings of the group entities as well as devising schemes of arrangement or DOCAs to enable the restructure of some or all of the members of the corporate group to occur at the same time. Such arrangements must be approved by the creditors of each entity within the group and can be difficult to achieve.

1.1 Corporate group versus individual legal entity

1.1.1 The insolvency and restructuring systems that are in force

As noted, in Australia the courts and legislature strictly adhere to the "separate legal entity" doctrine, which requires each entity within a corporate group to be dealt with separately in the event of an insolvency or a restructure (or indeed any other relevant transaction).

The limited exception to this is in instances where "pooling" applies in circumstances of the winding up of corporate groups (as discussed below). Additionally, in some instances, courts have indicated a willingness to "pierce the corporate veil" in a corporate group context when considering the obligations of directors, though this is extremely limited and no clear rule has emerged.[1] Importantly, there is no case law that has overridden the underlying separate legal entity concept applied to corporate groups when facing insolvency or the need to restructure.

1.1.2 Definition of a corporate group

There is no definition of a corporate group in Australian law, though numerous corporate entities often form a single enterprise.

The Corporations Act provides for the following concepts with respect to "corporate groups":

- holding, subsidiary and related companies; and
- parent companies and controlled entities.[2]

In simple terms, in Australia, a holding company and its subsidiaries are related companies forming a corporate group.[3]

The concept of a "corporate group" for the purpose of insolvency proceedings has also been acknowledged by the High Court of Australia in *Walker v Wimborne*.[4] In that case, Justice Mason described corporate groups as "a number of companies which are associated by common or interlocking shareholdings, allied to unified control or capacity to control."

Despite the identification of the concept of the corporate group, Australian courts still adhere to the separate entity doctrine, requiring each entity and its interests to be considered separately.

1.1.3 Legislation relating to corporate groups

Aside from the concepts with respect to pooling, the Corporations Act does not provide a specific regime for dealing with a group of companies in a winding up or restructuring context.

The pooling regime in a winding up context is the only recommendation to be taken up by the legislature from the Companies and Securities Advisory Committee "Corporate Groups Final Report"[5] (Corporate Groups Report), published in May 2000.

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1 *Equiticorp Finance Ltd (in liq) v Bank of New Zealand* (1993) 32 NSWLR 50; c.f. *Walker v Wimborne* (1976) 137 CLR 1.

2 Corporations Act, ss 9, 46, 49, 50, 50AA, 50AAA.

3 *Idem*, s 50.

4 (1976) 137 CLR 1, 532 (per Mason J).

5 May 2000. Available at: http://www.camac.gov.au/camac/camac.nsf/byheadline/pdffinal+reports+2000/$file/corporate_groups_may_2000.pdf

The Corporate Groups Report made numerous recommendations to alter and enhance the ability of IPs to deal with corporate groups in various formal insolvency proceedings. There have been a number of reforms to corporate insolvency in Australia since the Corporate Group Report. However, apart from pooling, there has been no push to pursue any of the recommendations made with respect to providing for the insolvency or restructuring of corporate groups.

1.2 Corporate group versus individual corporate benefit

1.2.1 The existence and relevance of "corporate group benefits"

As a common law country which adheres to the separate legal entity doctrine (described above), Australia adopts the principle at first instance that a transaction of a company must be in its best interests, rather than in the interests of a corporate group as a whole. Otherwise, the transaction stands to be set aside in an insolvency context.

1.2.2 Director liability

As a general rule, directors of group companies owe fiduciary duties to each individual company within the group and not to other companies within the group. As a practical matter, this can mean that where "group" directors make decisions and act in the group's overall interests, those directors may be placed in a position of conflict between the fiduciary duty which they owe to each individual entity within the corporate group and the possible requirements of the corporate group as a whole.[6]

For example, Australian law does not permit company directors appointed to multiple entities within a corporate group to treat the corporate group as a single entity for the purpose of transferring funds or collateral (for the provision of securities), notwithstanding that such a transaction may have been for the collective benefit of the corporate group.[7]

There are limited exceptions to the general rule. For example, the Corporations Act deems that a director of a subsidiary continues to act in good faith in the best interests of the subsidiary notwithstanding that it has taken into account the interests of the holding company in specific circumstances.[8]

As noted above, on occasion there has been some flexibility given to the application of the separate legal entity doctrine in Australia. There has been judicial recognition that directors of group companies may have regard to the commercial benefit to be derived by the particular company to which they are an office holder, and the extent of its continued prosperity or existence when that is dependent on the status of the corporate group as a whole.[9] The test to be applied by directors looking to consider whether a transaction may be entered into for the benefit of the corporate group as a

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6 These issues are considered in *Walker v Wimborne* (1976) 137 CLR 1 and *Equiticorp Finance Ltd (in liq) v Bank of New Zealand* (1993) 32 NSWLR 50.

7 *Walker v Wimborne* (1976) 137 CLR 1.

8 Section 187 of the Corporations Act provides: "A director of a corporation that is a wholly-owned subsidiary of a body corporate is taken to act in good faith in the best interests of the subsidiary if: (a) the constitution of the subsidiary expressly authorises the director to act in the best interests of the holding company; (b) the director acts in good faith in the best interests of the holding company; and (c) the subsidiary is not insolvent at the time the director acts and does not become insolvent because of the director's act."

9 *Equiticorp Finance Ltd (in liq) v Bank of New Zealand* (1993) 32 NSWLR 50.

whole always involves the director focusing on the benefit of the company of which they are a director, namely:

- assessing what benefits, if any, would result for the individual company from entering into the transaction; and

- if there are any benefits, what, if any, reasonably foreseeable detriments are there to the individual company.[10]

1.2.3 *"Early warning systems"*

Australian law does not require any "early warning systems" to be formally in place between the directors of its subsidiaries and the parent entity. However, pursuant to the Corporations Act, when a group company goes into liquidation it is possible that liability may be imposed on the holding company (or another group company) for some or all of the debts / losses of the insolvent group member if the subsidiary traded while insolvent.[11] This is subject to the legislative change in 2017, which provides a "safe harbour" for holding companies insofar as the holding company can provide evidence that it took reasonable steps to ensure that the directors of its subsidiary company were developing a course of action reasonably likely to lead to a better outcome for the subsidiary company and that the directors were taking that course of action.[12]

An Australian holding company can also be liable for the debts of its insolvent subsidiary in various circumstances, such as where a holding company is a "shadow" or "*de facto*" director of the subsidiary within the meaning of section 9 of the Corporations Act.[13] Alternatively, liability may attach where a group company knowingly assists common directors of the group company in breaching the directors' fiduciary duties or knowingly receives trust property as a result of such a breach.[14]

As a result of these potential bases for liability on the part of a holding company, in practice it is prudent for directors of entities within a corporate group to be well aware of the status of – or early warning signs given by – other members of the group in an effort to avoid liability for insolvent trading and the like.

The Corporate Groups Report made some recommendations that Australia should adopt a single enterprise principle in regulating corporate groups. However, the recommendations have not been taken up to date.

1.3 Universalism versus territorial principle

1.3.1 *Application of the modified universalism rules*

In theory, Australia is said to adopt the approach of universalism to cross border insolvency. However, recent case law suggests that Australia more readily accepts a

[10] See *Gamble v Hoffman* (1997) 24 ACSR 369, as an Australian interpretation of the United Kingdom test in *Charterbridge Corporation Ltd v Lloyds Bank Ltd* [1970] 1 Ch 62.

[11] Corporations Act, ss 588V, 588W.

[12] *Idem*, s 588WA(1).

[13] See, for example, *Buzzle Operations Pty Ltd (in liq) v Apple Computer Australia Pty Ltd* (2011) 81 NSWLR 47; c.f. *Grimaldi v Chameleon Mining NL (No 2)* (2012) 200 FCR 296.

[14] See the rule in *Barnes v Addy* (1874) LR 9 Ch App 244, as considered in *Farrow Finance Co Limited (in liq) v Farrow Properties Pty Ltd (in liq)* (1997) 26 ACSR 544.

"modified universalism" approach insofar as it accepts that, generally, it is desirable that assets should be collected and distributed in a single administration in the context of a cross-border insolvency.[15] Notwithstanding this approach, in practice, a discretion is reserved to local courts to administer the procedures surrounding a formal insolvency or restructuring in order to protect the local creditors' interests. Practically, it is unlikely that an Australian court would order the transfer of assets of an Australian company to an alternative jurisdiction for the benefit of creditors as a whole, nor is it likely that an Australian court would impose any laws other than its own in relation to insolvency law save for in circumstances where protections are put in place for the benefit of local creditors.[16]

Having adopted the United Nations Commission on International Trade Law Model Law on Cross Border Insolvency (Model Law), as incorporated into the Cross Border Insolvency Act 2008 (Cth) (CBIA), Australia has formally embraced the principles of modified universalism that are said to exist within the Model Law.

The courts (in considering disputes pursuant to the CBIA and the Model Law) have endorsed this approach subject to protections being afforded to Australian creditors. In *Akers v Deputy Commissioner of Taxation* (*Akers*),[17] notwithstanding that there was no formal liquidation proceeding on foot within the jurisdiction, the court in effect created a synthetic proceeding by tailoring the terms of the recognition order under the Model Law to allow for Australian creditors to receive the same return they would have received if they had they been entitled to prove in the main proceeding outside of the jurisdiction. The emphasis in *Akers* was in relation to the "notion of fair and equal treatment of all creditors, and the *pari passu* distribution of the assets of the debtor company".[18]

The Corporations Act also has formal provisions, which indicate an acceptance of the principles of modified universalism in cross-border insolvencies.[19] For example, Australian courts are entitled to issue and receive letters of request from courts of other countries for assistance in insolvency matters and have the power to facilitate the winding up of a registered foreign company in Australia or a company that has been conducting business in Australia but is not registered in the jurisdiction.[20]

1.3.2 *Bilateral and / or multilateral treaties in force*

As noted above, Australia has adopted the Model Law and the majority of its provisions were incorporated, unchanged, into the CBIA.

One of the most recent decisions of the Australian courts to affirm the principles of modified universalism was in *Akers*,[21] where Chief Justice Allsop commented:

> "The universalism that underpins the Model Law and [the CBIA] is one for the benefit of all creditors, and the protection of local creditors is

15 This was confirmed in *Akers v Deputy Commissioner of Taxation* (2014) 223 FCR 8.
16 *Ibid.*
17 *Ibid.*
18 *Idem*, [138].
19 Corporations Act, ss 580-581.
20 *Idem*, ss 583, 601CL(14)-601CL(15).
21 *Akers v Deputy Commissioner of Taxation* (2014) 223 FCR 8. The principle in *Akers* was also recently discussed and applied in *Wong (Trustee), Re Mackellar (Bankrupt) v Mackellar* [2020] FCA 1151, [63]-[66].

> expressly recognised. It is not inappropriate to call it 'modified universalism' for what such an appellation is worth."[22]

There are no current proposals in place to amend the Corporations Act or the CBIA with respect to the issues raised above.

1.3.3 Pending legislation

There is no pending legislation in relation to these issues.

1.4 Competent court and applicable law

The Federal Court of Australia (which has registries and sits in each jurisdiction of Australia) or, in some instances, the Supreme Court of each State and Territory, are the competent courts to perform functions relating to domestic and cross-border insolvency with regards to an individual corporate entity or a corporate group structure.

Given the adoption of the Model Law, Australian courts commence from the rebuttable presumption in article 16(3) that the centre of main interests (COMI) of a corporate entity is the location of its registered office. Recent cases in the Federal Court of Australia have affirmed this position.[23]

However, the presumption has also been successfully rebutted in some Australian decisions. *In Re Buccaneer Energy Ltd,*[24] the Federal Court held that, on the totality of the evidence, the COMI of the entity concerned was the United States of America, notwithstanding that the relevant entity was registered in Australia.[25]

Similarly, in *Yakushiji v Kaisha* (*Yakushiji*),[26] the court was required to determine the COMI of both a holding company and its subsidiary. The court relied on the rebuttable presumption that the COMI of the holding entity was Japan, being the place of the entity's registered office (the balance of the evidence also confirmed this).[27] However, in circumstances where the registered office of the subsidiary was in Panama, the task of establishing that the COMI of the subsidiary was also in Japan required the presumption to be rebutted. In determining that the COMI of the subsidiary was that of the holding entity, the court examined:

- where the company was incorporated, maintained its business and its presence;

- the stock exchange it was listed upon;

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22 *Akers v Deputy Commissioner of Taxation* (2014) 223 FCR 8, [120].

23 *Akers v Saad Investments Company Ltd (in official liquidation)* (2010) 190 FCR 285; *Young JR (on behalf of debtor in possession of Buccaneer Energy Ltd) v Buccaneer Energy Ltd* [2014] FCA 711; *Chong (as joint and several judicial managers of CNA GROUP LTD) (under judicial management) v CNA Group Ltd (under judicial management)* [2015] FCA 1148; *Yakushiji (in his capacity as foreign representative of Kaisha) v Kaisha* [2015] FCA 1170; *Didyasarin (in their capacity as foreign representatives of Thai Airways International Public Co Ltd) v Thai Airways International Public Co Ltd* [2020] FCA 1154.

24 *Young JR (on behalf of debtor in possession of Buccaneer Energy Ltd) v Buccaneer Energy Ltd* [2014] FCA 711.

25 *Idem*, [12]-[14].

26 *Yakushiji (in his capacity as foreign representative of Kaisha) v Kaisha* [2015] FCA 1170.

27 *Idem*, [10].

- where the company's directing mind (and directors) were located;
- the location of the company's headquarters;
- the details in the company's annual report;[28]
- the location of the company's assets;
- the operations of the company, including employees and administrative functions;
- the location of creditors; and
- the circumstances of the parent company.[29]

Given that there is no recognition of the "group" concept in Australian law, any decisions in relation to COMI will be with respect to the COMI of each entity that is seeking relief in Australian courts. Such was the approach of the court in *Yakushiji*, where, notwithstanding that the court determined that the COMI of both the holding company and the subsidiary was Japan, a separate determination was made with respect to each entity.

1.4.1 Applicable law that falls outside of the lex fori concursus and related issues

Pursuant to private international law principles, the laws of Australia (relevantly, the Corporations Act, the CBIA and common law) apply to the winding up or restructure of companies that are either registered in Australia or regarded as foreign companies for the purpose of a winding up in the jurisdiction. The laws of Australia in relation to restructuring and insolvency are federal laws, which apply equally in each state and territory within the country. As such, save for issues with judicial interpretation of the applicable law, the laws associated with an insolvency or restructuring proceeding will remain consistent throughout Australia.

With respect to cross border insolvencies, one aspect of an insolvency proceeding which may not employ the *lex fori* of Australia, in the absence of court orders to the contrary, is with respect to movable and immovable property. For example, a local liquidator is authorised by the Corporations Act to take into custody or bring under their control property to which the company is or appears to be entitled.[30] "Property" for the purpose of the Corporations Act is defined to include "any legal or equitable estate or interest … in real or personal property of any description and includes a thing in action."[31] However, clearly the definition of "property" does not purport to include property of the corporate entity outside of the jurisdiction. This is in contrast to Australia's personal bankruptcy legislation.[32] As such, it is arguable that a liquidator will be unable to effect one of his or her primary functions, namely to realise a

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28 For specific consideration of this aspect of determining the corporate debtor's COMI, see *Young JR (on behalf of debtor in possession of Buccaneer Energy Ltd) v Buccaneer Energy Ltd* [2014] FCA 711, [9]-[11].

29 *Yakushiji (in his capacity as foreign representative of Kaisha) v Kaisha* [2015] FCA 1170, [11]; see also the considerations in *Young JR (on behalf of debtor in possession of Buccaneer Energy Ltd) v Buccaneer Energy Ltd* [2014] FCA 711, [9]-[11].

30 Corporations Act, s 474.

31 *Idem*, s 9.

32 Bankruptcy Act 1966 (Cth), s 5 specifically defines property to include real or personal property "whether situate in Australia or elsewhere".

company's assets in order to wind-up the company's affairs, in the absence of a recognition order where property is located outside of the jurisdiction.

In such cases, it may be that the law of the place where the property is located will need to be applied rather than Australian law. Further, if the property is the subject of a security in favour of an overseas creditor, it is unlikely that an Australian court will disturb the rights of that secured creditor where such rights are valid according to the relevant state's local laws.

Intellectual property rights may also fall outside of the *lex fori* under the principles of Australian private international law depending on the place of registration of such rights. In Australia, copyright cannot be registered. As such, it appears that any rights would accrue where the copyright holder has their domicile. However, in relation to patents and trademarks, which are registrable, the rights accruing to the owner are to be taken to have accrued in the place where those interests were created and where they may be effectively transferred.

1.4.2 Harmonisation of substantive restructuring and insolvency laws

Harmonisation of substantive restructuring and insolvency laws would be of great assistance in cross border restructuring and insolvency cases to the extent that there are differing principles underlying the applicable law governing each company within a corporate group.

The incorporation of the Model Law into domestic legislation has gone some way to improving the situation in Australia in relation to cross border cases. However, the strong history of common law principles in Australia means that any interpretation of the Model Law is likely to be based on similar interpretations in other like common law countries. As such, many benefits that could be derived from the experience of civil law jurisdictions may be limited in the absence of substantive laws being implemented, such as in the form of a treaty, given the legal traditions of the jurisdiction.

1.4.3 Applicable treaties and case law

See the discussion on the Model Law and the related cases above.

1.4.4 Upcoming new legislation

There is no proposal for any new legislation in relation to this issue.

2. Substantive consolidated restructuring proceedings versus synthetic group restructurings

In Australia, the key tools to achieve a restructure of either a group of companies or an individual company (including the transfer of some or all of the business assets) are:

- a scheme of arrangement or compromise (members or creditors), regulated by Part 5.1 of the Corporations Act;

- a members' voluntary liquidation, regulated by Parts 5.5 and 5.6 of the Corporations Act; and

- voluntary administration followed by the execution of a DOCA, regulated by Part 5.3A, Division 10 of the Corporations Act.

The first two options are typically used where the entity, or entities, concerned are not insolvent (indeed, the second option is not available in circumstances where the entity, or entities, concerned are insolvent). The DOCA option is available where the relevant entity, or entities, concerned are insolvent and have been through voluntary administration (and creditors have resolved that a DOCA be entered into).

2.1 Schemes of arrangement

Several major debt restructurings in Australia over the last few years have been effected by way of a scheme of arrangement.[33] In essence, a scheme provides a mechanism that binds all creditors or members, or creditors or members in a particular class, to a compromise or arrangement.[34] The critical aspect of the scheme is the concept of a "compromise" or "arrangement", which requires court approval and binds the company's creditors (including secured creditors) and members to a form of rearrangement of existing rights and obligations.

It is important to note that schemes tend only to be used in Australia in large corporate restructures where timing is not critical. A significant disadvantage of the scheme process is the time necessary (realistically in the vicinity of six months) to effect the heavily regulated process. While there are law reform proposals for the scheme of arrangement process to be simplified, these are yet to be implemented at the time of writing.

Steps include:

- the preparation of explanatory statements and scheme booklets for creditors;

- notification to the regulator, the Australian Securities and Investments Commission (ASIC);

- an application to the Federal Court of Australia to approve the convening of scheme meetings;

- the holding of such meetings where the necessary creditor approval threshold is 75% in value and 50% in number of creditors in each affected class of creditor (or in the case of members, passed by a majority in number of voting members with 75% of share capital). Classes of creditors (or members) are determined by reference to commonality of legal rights. Only creditors whose rights will be affected by the scheme need to be included in a vote;

- if passed by the relevant creditors (or members), final Federal Court approval of the scheme; and

[33] *Re Centro Properties Ltd* (2011) 87 ACSR 131; *Re Centro Properties Ltd* (2011) 86 ACSR 584; *Nine Entertainment Group Ltd (No 1)* (2012) 211 FCR 439; *Nine Entertainment Group Ltd (No 2)* [2013] FCA 40; *Re Atlas Iron Ltd* [2016] FCA 366; *Re Atlas Iron Ltd* [2016] FCA 481; *Re BIS Finance Pty Ltd; Artsoning Pty Ltd* [2017] NSWSC 1713 and *Re BIS Finance Pty Ltd; Artsoning Pty Ltd* [2018] NSWSC 3.

[34] Corporations Act, s 411. Creditors for the purpose of s 411 of the Corporations Act are those that would have a provable claim or debt should the company be wound up in liquidation: *Re Glendale Land Developments Ltd* [1982] 2 NSWLR 563.

- the filing of the court order (once such scheme is approved) with the regulator.

In order to effect the restructure of a corporate group, the court is able in certain circumstances to order the consolidation of meetings of creditors.[35]

Once approved, the acts of the scheme administrator in effecting the scheme will differ depending on the nature of the scheme. However, one of the critical aspects of the scheme is the distribution of funds to creditors. As noted, the flexibility of the scheme means that monies are paid in accordance with the terms of the scheme document rather than the ordinary principles provided for in the Corporations Act.

When dealing with large corporate groups, there are specific provisions in the Corporations Act which may assist the transfer of assets and liabilities from wholly (not partly) owned subsidiaries. For these provisions to be effective, the scheme transfer is of all of the undertaking, property and liabilities of the wholly owned subsidiaries to the holding company. In turn, the creditors of the subsidiaries will be treated as creditors of the holding company.

In these circumstances, the court is able to order the consolidation of meetings of creditors of the holding company and the wholly owned subsidiaries if it is satisfied that the number of meetings would otherwise impede creditors from considering the scheme in a timely manner.

2.2 Members' voluntary liquidation

An alternative course for transferring assets of a solvent group company into another entity within a corporate group can be achieved by a voluntary liquidation. The process can only be undertaken with respect to "solvent companies" (as such, the interests of creditors are protected). This form of winding up is known as a members' voluntary winding up and can be used to distribute assets of companies in a group to members with a view to closing down some entities in favour of restructuring others.

The winding up is initiated by the company passing a special resolution with 75% of the members attending voting in favour.[36] Prior to the meeting, a majority of the directors must provide a written declaration that the company will be able to pay all of its debts within 12 months from the commencement of the winding up.[37] Once the resolution is passed, an ordinary resolution will then need to be passed to appoint a liquidator, after which the liquidator will commence the tasks necessary to wind up the company's affairs. Court approval is not required.

A limitation of this process is the powerlessness of the liquidator to simultaneously assign to a receiving body corporate the liabilities of a company being wound up. Accordingly, sufficient assets must be retained in the company being wound up to discharge any liabilities. However, this may be able to be overcome if, after a liquidator has been appointed, the liquidator decides that it is appropriate to make a "pooling determination"[38] or to seek a "pooling order",[39] which in effect will see each company within a corporate group being jointly and severally liable for debts payable and claims against each other company within the group. This is discussed further

35 Corporations Act, ss 411(1A)-411(1B).
36 *Idem*, s 491(1).
37 *Idem*, s 494(1).
38 *Idem*, s 571.
39 *Idem*, s 579E.

below. However, it should be noted that the meeting requirements differ to those described below in the context of an insolvent liquidation.

2.3 Deeds of company arrangement

A DOCA facilitates a process approved by creditors, which allows for the reconstruction of a company's affairs or business in circumstances where the company is insolvent. The DOCA is administered by an IP in their capacity as a "deed administrator". The DOCA can be proposed by anyone with an interest in the company and there are few restrictions on what can be proposed in a DOCA.

A DOCA can be proposed as an alternative to liquidation (winding up) at the conclusion of a voluntary administration. Typically, creditors will only approve a DOCA (or series of DOCAs) in circumstances where the return to creditors is greater than it otherwise would be in a winding up. This usually requires the DOCA proponent or other third party to tip in additional cash, or exchange debt for equity (see further below) to make it more attractive.

Although not specifically noted in the Corporations Act, a DOCA, or a series of DOCAs, can effectively restructure the affairs of a corporate group of companies.[40] It is possible for a DOCA (or series of DOCAs) to provide for an arrangement where the assets and liabilities of a corporate group are dealt with simultaneously, though an administrator proposing to put such an arrangement to creditors should seek the court's directions that it is appropriate to do so. Such an arrangement was approved by the Court in *Mentha v GE Capital Ltd*.[41]

3. Duty to initiate insolvency process

There is no obligation in Australia for directors to "open a restructuring procedure", save for when it may be considered that such a step is required for directors to discharge their directors' duties as prescribed at common law and by the Corporations Act.[42]

An assurance or guarantee from other entities within a corporate group, as purported justification for failing to take a necessary step to enter into some form of insolvency proceedings with respect to bankruptcy or restructuring (where such step is required by the Corporations Act), will not relieve directors of their duties to act. This is on the basis that each company within a corporate group must be treated as having its own interests, even if it is a wholly owned subsidiary, and in particular it is incumbent on directors of a company that is in financial difficulties to consider the interests of the creditors of the individual companies within a corporate group rather than the group as a whole.

If the critical requirements for commencing an insolvency process under the Corporations Act are met, directors who continue to trade a company registered in Australia that is insolvent or likely to become insolvent face potential liability for

40 *Mentha v GE Capital Ltd* (1997) 27 ACSR 696.
41 *Ibid.*
42 See Corporations Act, ss 180-181 for general duties of care, diligence and good faith. See Corporations Act, s 187 for the duties of directors of wholly owned subsidiaries

insolvent trading and the payment of compensation to the company[43]or, in certain circumstances, to creditors of the company directly.[44]

An exception to this principle is the recent amendment to the Corporations Act to include a "safe harbour" carve-out to directors' insolvent trading liability where a restructure proposal is put forward in the twilight of insolvency.[45] However, the safe harbour provisions are yet to be tested in any meaningful way in the courts and commentators have expressed the view that the uncertain application of the provisions will mean that, in the majority of cases, directors may prefer to place a company into external administration (and thus avoid the prospect of insolvent trading liability) than to avail themselves of the safe harbour carve-out.[46] As such, the practical position is that there are very limited circumstances in which a director of a company which is insolvent or irretrievably approaching insolvency (whether it is part of an international corporate group or otherwise) would not appoint an administrator.[47]

In specific circumstances, Australian courts have jurisdiction to order the winding up of registered foreign companies or foreign companies not registered but carrying on business in Australia.[48] This is regardless of whether a company's directors commence the insolvency proceeding.[49] In most instances, the function of the local proceeding would be limited to the collection and protection of local assets for the benefit of the company's creditors.[50]

However, as noted above, Australian courts have been faced with circumstances where there is no local insolvency proceeding, yet they have still put in place measures as part of a recognition order, under the Model Law, to in effect have a synthetic proceeding to protect the local assets for the benefit of local creditors.[51]

In *Akers,*[52] foreign liquidators sought recognition of a Cayman Islands proceeding and, in particular, sought to realise assets of the foreign company within Australia. The only unsecured creditor in Australia was the statutory taxation authority. As part of the recognition order, the foreign liquidators provided cross-undertakings with the local creditor that proceeds of realisations from Australian assets would not be remitted outside of Australia. A local liquidator was appointed to realise the local assets and at the appropriate time notice was given to the local creditor that the proceeds of the

43 *Idem*, ss 588G, 588J.
44 *Idem*, ss 588M, 588R-588U.
45 *Idem*, s 588GA.
46 See eg Ramsay and Steel, "The 'Safe Harbour' Reform of Directors' Insolvent Trading Liability in Australia – Insolvency Professionals' Views" (2020) 48(1) *Australian Business Law Review* 7.
47 It is likely that the only circumstances where a director would refrain from appointing an administrator would be if a standstill or forbearance agreement was negotiated with creditors, prior to the need for the appointment, to ensure that debts were not described as "due and payable" for the purpose of the Corporations Act. This is on the basis that Corporations Act, s 95A states that a person is solvent "only if the person is able to pay all the person's debts, as and when they become due and payable." Conversely a person is insolvent if they are not solvent: s 95A(2).
48 *Idem*, s 583(c) prescribes that a company, of the type referred to, may be wound up if : (i) it is unable to pay its debts, has been dissolved or deregistered, has ceased to carry on business in the jurisdiction or have a place of business there; (ii) if the Court thinks that it is just and equitable to wind it up; or (iii) if ASIC has provided the necessary opinions in relation to the company's in ability to pay its debts or that a winding-up would be in the interests of the public, the members of the creditors.
49 *Idem*, s 583.
50 *Idem*, s 583(d).
51 *Akers v Deputy Commissioner of Taxation* (2014) 223 FCR 8.
52 *Ibid.*

realisations were to be remitted to the foreign jurisdiction. The Federal Court of Australia did not order the release of the Australian assets to the foreign liquidators without clarity that those assets would be made available to local creditors.[53] Accordingly, notwithstanding that the recognition order was made, and a synthetic proceeding in effect endorsed, directions were still required from the court with respect to the local synthetic proceeding and in particular in relation to the local creditors' rights.

4. Legal certainty and predictability

4.1 Legal certainty and predictability to local creditors

If a guarantee is provided by a foreign IP, it is unlikely that a formal insolvency proceeding would not be opened in Australia, if the relevant criteria for such opening is met and a company is registered in Australia (including a foreign registered company) or carrying on business in Australia. However, if this is not the case, legal certainty and predictability may be provided to local creditors through a variety of mechanisms including the CBIA and the Model Law and, to the extent that a recognition order is sought, judicial determinations and provisions within the Corporations Act.[54]

In particular, with respect to the winding up of foreign registered companies and / or foreign companies that are unregistered but carrying on business in Australia (Foreign Companies), local creditors are provided with some certainty by:

- reserving a right to wind up the Foreign Companies;
- conducting any wind up in accordance with local laws;[55]
- requiring ASIC to be notified when a foreign company commences to be wound up, dissolved or deregistered in its place of origin;[56]
- reserving an entitlement to ASIC to seek the appointment of a local liquidator to the foreign company and requiring that local liquidator to advertise and invite all creditors to make their claims against the foreign company;[57] and
- restricting the rights of the local liquidator from paying out, in the absence of a court order, any creditor to the exclusion of another.[58]

4.2 Communications with local courts and creditors

The required publicity for local creditors is prescribed by the Corporations Act depending upon the type of procedure that is being undertaken. Each publication is dealt with within this report when describing the processes for each type of relevant insolvency proceeding or restructuring process.

53 *Ibid.*
54 Corporations Act, ss 583, 585.
55 *Idem*, s 582(1)
56 *Idem*, s 601CL(14)(a).
57 *Idem*, s 601CL(14)(b).
58 *Idem*, s 601CL(15)(b).

With respect to judicial cooperation, the grounds for such cooperation where there is a winding up in a foreign jurisdiction are:

- CBIA cooperation as prescribed in the Model Law;
- Australian courts acting in aid of a foreign court that has jurisdiction in external administration matters;[59]
- Australian courts requesting a court of an external state, that has jurisdiction in the applicable external administration, to act in aid of the Australian court in the external administration matter;[60] and
- a court's inherent jurisdiction.[61]

4.3 Guarantees by the IP in office

The concept of a "guarantee" in monetary terms from an IP to another IP is not a common Australian concept.

5. Consolidation of assets

5.1 Procedure with respect to the sale of the whole or part of a business

The sale of some or all of the assets of an entity pursuant to the Corporations Act differs significantly depending upon whether the sale forms part of an insolvency process or an informal restructuring.

5.1.1 Restructuring

As noted above, in Australia the key tools to achieve a restructuring – which will include the sale or transfer of the whole or part of a business, of either a group of companies or an individual company (including the transfer of some or all of the business assets) – when the company, or companies concerned, are not insolvent are:

- a members' voluntary liquidation; or
- scheme of arrangement (members of creditors*)*.

Whether transferred as part of these processes or outside of these processes, the sale may be subject to specific mergers and acquisitions laws and trade practices laws, which go beyond the scope of this report. For example, in Australia, the law prohibits a transfer or a takeover, which would have the effect, or would likely have the effect, of substantially lessening competition in any market.[62]

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[59] *Idem*, ss 580-581.

[60] *Idem*, s 581(4).

[61] In *Re Chow Cho Poon (Private) Ltd* (2011) 80 NSWLR 507, [78]-[79] Barrett J considered (but did not conclude) whether the court could grant recognition and declaratory relief without reference to any statutory foundation by deployment of the local court's inherent jurisdiction.

[62] Competition and Consumer Act 2010 (Cth).

5.1.2 *Insolvency*

- *Voluntary administration / DOCA*

  In the insolvency context, a sale or transfer of the assets of a single company, or an entity within a corporate group, may be effected through the voluntary administration process or by way of a DOCA (as described above).

  An IP who is a voluntary administrator or a deed administrator has broad powers to dispose of a company's assets (or those of a group of companies in circumstances where the IP holds several appointments over group entities).[63] There are restrictions on a voluntary administrator's ability to dispose of property subject to security interests.[64] However, the disposal or transfer of assets need not be specifically approved by a company's creditors or members. In transferring assets, an IP will, however, always be mindful to ensure that the course is in the best interests of creditors.

  A DOCA may similarly provide for the disposal of a company's or a group of companies' assets. A DOCA which purports to do so must be approved by creditors at a meeting convened pursuant to the Corporations Act.[65] The quorum required at the meeting is at least two persons (or if only one person is entitled to vote, just that person).[66] The resolution for a DOCA will be decided on the voices, unless a poll is demanded, in which case the resolution will only pass if a majority of the creditors voting (in person or by proxy or attorney) vote in favour and these creditors have the majority in value of debt.[67] In addition, and as noted below, the deed administrator may dispose of a company's shares under a DOCA in circumstances where he or she has the consent of the shareholders or leave of the court.[68]

  As foreshadowed above, neither the voluntary administration nor DOCA provisions of the Corporations Act specifically deal with the disposal of assets of a corporate group, though a disposal or transfer of these assets may be attractive to the IP or the group's creditors, as often the sale of a business as a whole achieves a greater return for creditors. As set out further below, recent decisions suggest that a court has the flexibility to approve a "pooling" type regime to allow for the consolidation and disposal of a group's assets.

- *Liquidation*

  By far the easiest method to realise the consolidated assets of a corporate group is following the resolution of creditors that companies within a group of companies are to be wound up in insolvency.

  In the context of liquidation, Australia has a statutory pooling regime under the Corporations Act to facilitate the winding up of companies within a corporate group.[69] Pooling pursuant to these statutory provisions produces the ultimate

63 Corporations Act, s 437A.
64 *Idem*, Part 5.3A, Subdivision 7B.
65 *Idem*, s 439A. As to what creditors can decide at the meeting see Corporations Act, s 439C.
66 Insolvency Practice Rules (Corporations) 2016 (IPRC), s 75-105(2)
67 *Idem*, ss 75-110(1), 75-115(1).
68 Corporations Act, s 444GA.
69 *Idem*, Part 5.6 Division 8.

result that a company's assets are pooled for the purpose of their realisation and distribution to the entire corporate group's creditors on a *pari passu* basis.[70] There are special rules for dealing with secured creditors and priority and eligible employee and unsecured creditors.

A pooling regime can be started in one of two ways for a particular corporate group:

i. *"Voluntary pooling"* – at the instigation of a liquidator who makes a pooling "determination".[71] A pooling determination can only be made by a liquidator where there is a group of two or more companies and each of those companies is being wound up and one of the following conditions is met:

   - each company in the group is a "related body corporate" of each other company in the group;

   - the companies are jointly liable for one or more debts or claims;

   - the companies in the group jointly own or operate particular property that is or was used, or for use, in connection with a business, a scheme, or an undertaking, carried on jointly by the companies in the group; and

   - one or more companies in the group own particular property that is or was used, or is for use, by any or all of the companies in the group in connection with a business, a scheme, or an undertaking, carried on jointly by the companies in the group.[72]

   The pooling determination is then put to the creditors of each company in the group to be passed by resolution.[73] Specific information must accompany the notice to creditors of the meeting, including advantages and disadvantages of the pooling determination if it came into force.[74] Creditors' meetings of each company within the group must be held separately.[75] Only "eligible unsecured creditors" can vote at the meeting,[76] which, broadly speaking, excludes creditors who are members of the corporate group.[77] In order for the resolution to pass, a majority of creditors voting in favour and a majority in value of those creditors voting must vote in favour of the pooling resolution.[78] In order for the pooling determination to take effect, all companies within the group (and within the ambit of the determination) must pass the resolution.

   There is a degree of flexibility in crafting the pooling determination in a "just and equitable manner" to suit the situation at hand.[79] Alternatively, once in force, a pooling determination can be varied by the liquidator and approved by creditors by resolution.[80]

70 *Idem*, s 556.
71 *Idem*, s 571.
72 *Idem*, s 571(1)(b).
73 *Idem*, s 577(1A).
74 IPRC, s 75-180(3).
75 Corporations Act, s 577(1A).
76 *Idem*, s 577(1).
77 *Idem*, s 579Q.
78 *Idem*, s 577; IPRC, s 75-190(2).
79 Corporations Act, s 571.
80 *Idem*, s 577.

The court also has powers to vary, terminate, cancel or confirm (in whole or part) a pooling determination.[81] Most importantly, a creditor (or a member, in a members' voluntary winding up) can apply to the court for variation or termination in circumstances where false or misleading information was given to creditors regarding the termination, or it is unfair or prejudicial to certain creditors (or members).[82]

ii. *"Court approved pooling"*[83] – the same conditions as those listed above must exist for a pooling order to be made. The court will only make such orders when it is satisfied that it is "just and equitable to do so."[84] The order may be varied on the application of the liquidator or a creditor (or a member in a members' winding up).[85] The court can make and vary "ancillary orders" to the pooling orders it makes. For example, it may order that certain debts or claims (or classes thereof) be excluded from the pooling regime. It may order or direct the transfer of a liability, claim or property from a company in the group to another company in the group.[86]

Pooling regimes (or regimes with the effect of pooling assets and / or liabilities of corporate groups) have also been ordered, or sanctioned by the court, in contexts outside of the statutory pooling regime. For example, in *Re Koko Black Group Pty Ltd (admins apptd)* (*Re Koko Black Group*),[87] the liquidators of the Koko Black Group of companies applied for orders and directions that the resolutions of the companies' creditors to combine recoveries, costs and distributions to creditors of all of the other Koko Black Group of companies be acted on by the liquidators.

The resolutions were passed at the meeting of creditors of the Koko Black Group of companies, while those companies were still in voluntary administration (at the same meeting, the entire group was also placed into liquidation). The liquidators sought directions and orders after the meeting that the resolutions be effective pursuant to the broad powers in the Corporations Act that allow IPs to seek directions as to the conduct of a voluntary administration or winding up.[88] In making the relevant directions and granting the relief sought, the judge noted that

> "although there are pooling provisions in Part 5.6 of Division 8 of the Act [referred to above] … it was submitted that they are not a 'Code' and accordingly not a reason against the making of the orders sought under other provisions of the Act. I agree."[89]

81 *Idem*, ss 579A, 579B.
82 *Idem*, s 579A.
83 *Idem*, s 579E.
84 *Idem*, s 579E(1). For other matters relevant to the "just and equitable" criteria, see s 579E(12).
85 *Idem*, s 579F.
86 *Idem*, ss 579G, 579H.
87 [2016] VSC 190.
88 Corporations Act, ss 447A, 511; *Insolvency Practice Schedule (Corporations)* at Schedule 2 of the Corporations Act (IPSC), ss 90-15, 90-20.
89 *Re Koko Black Group Pty Ltd (admins apptd)* [2016] VSC 190. Note that similar directions and orders were made in *Dean-Willcocks v Soluble Solution Hydroponics Pty Ltd* (1997) 42 NSWLR 209.

Hence, the operation of pooling "procedures" is not always confined to the regime outlined in the Corporations Act. *Re Koko Black Group* suggests that there is scope within formal administration procedures for creditors to resolve that "informal" pooling procedures are appropriate and, where necessary, these will be sanctioned by the court. See also *Re Grocon (admins apptd) (No 1)*[90] to the extent that the statutory regime for operating separate post-administration accounts[91] was varied by the court to enable the administrators of the Grocon Group to combine monies received from various entities within the Group into a single treasury account and to pay costs and expenses of the administration of the Grocon Group from that single treasury account prior to any formal pooling orders being made.

It is also relatively common for liquidators of a group of companies to seek directions from a court that they are justified and acting reasonably in pooling corporate group funds in a winding up, particularly where there is an established pattern of commingling funds within a group and such an arrangement would be to the benefit of the vast majority of creditors within that group.[92] Most recently, the Federal Court of Australia and the High Court of New Zealand heard a proceeding in which liquidators sought such directions jointly, the latter acting in aid and auxiliary to the former.[93]

In a like way, it is possible for creditors of each entity within a group to resolve that pooling-like procedures occur within deeds of company arrangements and schemes of arrangements.

5.2 Difference in treatment with respect to tangible and intangible assets

There is no different treatment with respect to tangible and intangible assets. In Australia, it is unlikely that the difficulty surrounding the segregation of an asset will be determinative as to whether it receives different treatment with respect to consolidation between companies within a corporate group. The nature of the asset and the extent of the co-mingling may be relevant to a court in determining whether specific orders should be made around any consolidation in a formal insolvency process (or restructuring process that requires court approval) but the form of the asset itself will not be the determining factor.

5.3 Role of creditors and creditors' committees in a substantive consolidation

The role of creditors in a "consolidation of assets" differs depending on the process under which the consolidation is taking place. The role of creditors in a "consolidation of assets" differs depending on the process under which the consolidation is taking place, as outlined for each process below.

5.3.1 Deed of company arrangement

Any proposed consolidation takes place as part of the vote of creditors of each company, at the second creditors' meeting, on the terms of the DOCA as a whole. It is

90 [2020] VSC 833; see also *Korda, in the matter of Ten Network Holdings Ltd (Administrators Appointed) (Receivers and Managers Appointed)* [2017] FCA 1144.
91 IPSC, Division 65.
92 See, for example, *Re BBY Ltd (recs and mgrs apptd) (in liq) (No 2)* (2018) 363 ALR 492.
93 *Kelly v Loo* (2021) 390 ALR 669. An appeal was dismissed: *Loo, in the matter of Halifax Investment Services Pty Ltd (in liq) v Quinlan (liquidator)* [2021] FCAFC 186.

possible to have consolidated creditors' meetings. However, the vote of creditors must be with respect to each company within the group. All unsecured creditors have the same voting rights and a vote in favour of the DOCA can be carried on the voices. However, if a poll is demanded, the resolution in favour of the DOCA will be passed if a majority of the creditors, voting in favour of the resolution, are owed more than half of all debts owed to all creditors voting.[94] If no result is achieved, the administrator can exercise his or her casting vote.[95] However, if the creditors do not pass the resolution, for all relevant companies, the companies that fail to consent to the DOCA proposal will enter into liquidation.[96]

5.3.2 *Scheme of arrangement*

In order for a scheme to be effective, each creditors' meeting must vote in favour of the scheme proposal. The proposal will be passed if a majority of creditors entitled to vote, and who are present in person or by proxy, vote in favour of the scheme. The debts owing to that majority must be 75% of the total debts owed to creditors entitled to vote and who are present (or voting by proxy). As it is a requirement for a scheme to divide its creditors into separate classes, it is imperative when undertaking this task to consider the scope of each creditor class. For example, construing the creditor classes too broadly will empower a majority to oppress a minority who are likely to have different legal rights. Conversely, drawing the class too narrowly may enable a small minority in one class to frustrate the scheme for the majority.

5.3.3 *Winding up*

In order for a consolidation of assets to occur when entities within a corporate group are being wound up, there will need to be either a voluntary pooling arrangement or a pooling order made by the court.[97] As noted above, a voluntary pooling arrangement can only proceed if a majority in number and a majority in value of the eligible unsecured creditors present and voting agree to vote in favour of making the pooling determination.[98] A pooling determination will not take effect until the required majorities are obtained for any company within the proposed group.[99] If an eligible unsecured creditor objects to the pooling determination, they can apply to the court to have the determination varied or terminated on a variety of grounds, including that the determination will materially prejudice that creditor.[100] Arm's length secured creditors are excluded from pooling determinations to the extent of their security.[101] Similarly, with respect to court ordered pooling, courts may not make a pooling order if to do so would materially disadvantage an eligible unsecured creditor and that creditor has not

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[94] IPRC, s 75-115(1)
[95] *Idem*, s 75-115(3) subject to the meeting not being a meeting of eligible employee creditors in which case if no resolution is reached under IPRC, ss 75-115(1) or 75-115(2), then the resolution is not passed (s 75-115(7)).
[96] An alternative is to return the relevant company to the directors (Corporations Act, s 439C) but this is a rare occurrence in circumstances when a company has been placed into a voluntary administration on the basis of insolvency or impending insolvency.
[97] *Idem*, ss 571, 579E.
[98] *Idem* s 579Q; and see also IPRC s 75-115 and Corporations Regulations, reg 5.6.73. "Eligible unsecured creditors" in essence, include all unsecured creditors of the group but exclude other companies in the pooled group. For example, intra-group companies are excluded from voting or objecting to the pooling determination.
[99] Corporations Act, s 578(1).
[100] *Idem*, s 579A.
[101] *Idem*, s 571(9).

consented to the making of the order.[102] This will go some way to the court not being satisfied that the order is just and equitable – a prerequisite to its making.[103]

5.4 Voting for or against a substantive consolidation

These issues are outlined in detail above.

6. Equitable distribution and accountability of IPs

In Australia, because liquidation refers to a process where a company is wound up, there typically is no scope for a debt for equity swap within this process. Other forms of formal restructuring processes allow for debt for equity swaps to enable a company – or a group of companies – to continue in existence.

For example, the provisions of the Corporations Act which govern DOCAs provide that a deed administrator may transfer shares either with:

- the written consent of the owner of the shares; or
- the leave of the court.[104]

In practice, this transfer is typically in return for debt forgiveness under a DOCA. It will often be done in circumstances to enhance the attractiveness of the DOCA to creditors (who resolve to adopt it) over a liquidation, which is usually the other option presented to creditors.

In recent times, a debt for equity swap has been proposed (and approved by the court) in circumstances where a parent company puts up funds for the payment of the subsidiary's creditors under a DOCA (to ultimately allow the subsidiary company to continue in existence and be released from debts), but the parent receives shares in exchange. In *Re BCD Resources (Operations) NL*,[105] the transfer of shares, though opposed by certain shareholders, was approved by the court as the deed was an attractive alternative to a winding up, in which the shareholders would not have received anything anyway.[106]

Elsewhere, debt for equity swaps have been implemented in the context of statutory schemes of arrangement, referred to above. For example, In *Re Nine Entertainment Group Ltd (No 1)*,[107] the court ordered that meetings of creditors to approve a scheme take place (a key step in the scheme process) in circumstances where it was contemplated that senior and mezzanine lenders would receive only a partial return on their secured debt, but otherwise a substantial shareholding in the parent company. Certain secured lenders opposed the scheme. Importantly, the court made the relevant orders notwithstanding a section in the Corporations Act which provides for persons to become shareholders of a company only if they "agree" to be a shareholder. Here, some secured lenders indicated their disagreement to the debt for equity swap proposed. Again, the scheme appeared to the court to be an attractive

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[102] *Idem*, s 579E(10).
[103] *Idem*, ss 579E(1), 579E(12). For the meaning of "just and equitable", see *Re Lombe* (2011) 87 ACSR 84; *Lofthouse v Environmental Consultants International Pty Ltd* [2012] VSC 416.
[104] Corporations Act, s 444GA. Note that the application for leave may be opposed by certain persons.
[105] (2014) 100 ACSR 450.
[106] See also *Re Mirabela Nickel Ltd (subject to a Deed of Company Arrangement)* [2014] NSWSC 836.
[107] (2012) 211 FCR 439.

alternative to the other likely outcome: the collapse and winding-up of a large group of companies.

7. Intercompany claims

In circumstances where a DOCA is proposed to creditors, it is possible for creditors to vote in favour of terms that exclude intra-group loans from participating in the distributions under a DOCA arrangement. However, in ordinary circumstances Australian courts have no power to subordinate intra-group claims. The presumption is that claims of a parent or affiliate member of a corporate group rank *pari passu*. Typically, intra-group loan accounts and claims are examined by an IP with greater scrutiny than would otherwise be the case.

To the extent that an intra-group transaction is a voidable transaction, it may be set aside by the IP. For example, if a related entity company has been paid a voidable transaction (such as an unfair preference), there are rules which extend the relation-back period, having the effect of prolonging the period for which the IP can recover any voidable transactions from the related entity.[108]

If the claim by a parent or affiliate is not an ordinary loan or a claim, but a "subordinate claim" (being a claim for a debt owed by the company to a person in their capacity as a member, such as dividends, profits or otherwise, or any other claim that arises from buying, holding, selling or otherwise dealing in shares), then the subordinate claim is postponed until all other debts payable by, and claims against, the company are satisfied.[109] Note, however, this rule applies to all "subordinate" claims, and not just those within an intra-group context.

8. Administering a complex estate in one consolidated procedure

In theory, more than one "group" of companies within a corporate group could exist in a scenario where there was a restructure pursuant to a scheme of arrangement and / or DOCA depending on what compromise or arrangement is to be implemented. There is considerable scope for flexibility within these processes. However, difficulties would arise in effecting an "all of group" or a "multi-group" solution if the groups were not dealt with simultaneously.

In contrast, in a strict liquidation scenario, it would not be possible for different enterprise groups to exist, as the likely effect of this would be to interfere with the principles of universalism, the *pari passu* distributions to unsecured creditors and / or the rights of secured creditors. Further, the statutory pooling provisions (referred to above), do not appear to accommodate such a scenario. In particular, the criteria under the Corporations Act with respect to pooling determinations and court ordered pooling orders is that "each company in the group is being wound up". It would appear to be inconsistent with the concept of pooling all of the assets and liabilities of a corporate group if a liquidator could determine to only pool the assets and liabilities of some of the entities.

9. Handling an insolvent parent with a healthy subsidiary

As Australian corporate law is still very much based around the separate legal entity

[108] Corporations Act, s 588FE.
[109] *Idem*, s 563A.

doctrine, solvent subsidiaries cannot be consolidated within the insolvency proceeding (or administration) of their parent company.

As noted above, for the statutory pooling regime to apply, *all* entities within a corporate group must be in liquidation.[110] As such, it is extremely unlikely for a solvent subsidiary to form part of a corporate group for the purpose of a distribution to creditors. The only situation in which this is foreseeable is where the solvent subsidiary is being wound up for reasons other than insolvency. This could be either pursuant to a members' voluntary liquidation (though as noted above, such a scenario, and whether it is possible, does not appear to have been tested) or where the company is being wound up on "just and equitable" grounds.

Even so, in these circumstances, it is difficult to foresee creditors agreeing to, or a court sanctioning, a pooling regime, as there would likely be prejudice to the creditors and members of the solvent subsidiary, who would have to share realisations with creditors of the insolvent parent.

It is interesting to note that the Corporate Groups Report recommended that solvent group members should be permitted to enter into administration with other group companies where at least one of those companies satisfies the prerequisites for voluntary administration. To date, this recommendation has not been adopted.

110 *Idem*, Part 5.6, Division 8.

BELGIUM

1. Consolidated group restructurings versus cooperation or coordination procedure

The United Nations Commission on International Trade Law (UNCITRAL) Legislative Guide on Insolvency Law distinguishes between two types of insolvency regulations applicable to groups of companies: (1) the separate entity approach; and (2) the single entity approach. The latter avoids a total break-up of the group, the disintegration of the vital intra-group financial and operational components, the loss of synergies and a decrease in the value of the bankruptcy estate. An example of total loss of value due to lack of collaboration occurred in the insolvency of *KPN Qwest* in the Netherlands compared to the *Nortel Networks* case in Canada: the piecemeal sale of the KPN Qwest network resulted in a much greater loss compared to a relative financial success in the second matter.[1]

Professor Nico Dewaelheyns and Professor Cynthia Van Hulle, both economists at the Catholic University of Louvain (KUL) in Belgium, have proven with empirical studies based on effective data that Belgian subsidiaries of Belgian group companies that go into insolvency are more easily and more efficiently restructured than independent Belgian companies on their own.[2] We do not have similar data at an international level, but one could assume that, in principle, the conclusion should be the same.

Professor Oscar Couwenberg, economist at the University of Groningen in the Netherlands, has written on the cost and recovery rates in Dutch bankruptcy proceedings. He highlights the benefit of the size effect on the overall cost[3] and notes that the costs increase with the time it takes to sell a business.

Professor Lynn M. LoPucki and Judge Joseph W. Doherty have reported on the size of direct costs in a United States (US) Chapter 11 proceeding. They conclude that the larger the enterprise, the lower the costs as a percentage of the assets.[4]

Considering the economic benefits of consolidation proceedings, the question arises as to whether such a consolidated group restructuring proceeding is possible under the laws of Belgium. Except for what is mentioned below regarding the possibility of conducting "synthetic" group restructuring proceedings, Belgian law does not provide for consolidated group restructuring proceedings.

However, joint commencement of individual insolvency proceedings is possible for group companies in Belgium. When insolvency proceedings are opened against the consolidating company and / or multiple group companies, the insolvency practitioner (IP) appointed must continue to treat each company within the group as a separate legal entity. However, using one IP across a group of companies facilitates information flow and can provide for preservation of the estate, maximisation of value, facilitation of rescue proceedings and, in general, increases the efficiency of matters for the benefit of all the stakeholders.

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[1] I Kokorin and B Wessels, *Cross-Border in Insolvencies of Multinational Group Companies* (Edward Elgar Publishing, 2021) 20.

[2] N Dewaelheyns and C Van Hulle, "Filtering Speed in a Continental European Reorganization Procedure" (2009) 29(4) *International Review of Law and Economics* 375–387.

[3] O Couwenberg and S J Lubben, "The Costs of Chapter 11 in Context: American and Dutch Business Bankruptcy" (2011) *American Bankruptcy Journal* 63–85; O Couwenberg and A de Jong, "Costs and Recovery Rates in the Dutch Liquidation-Based Bankruptcy System" (2008) *European Journal of Law and Economics* 105–127.

[4] L Lopucki and J W Doherty, "The Determinants of Professional Fees in Large Bankruptcy Reorganization Cases" (2004) 1(1) March *Journal of Empirical Legal Studies* 111–141.

In addition, rules on coordination and cooperation exist in many international legislative instruments.

Firstly, the UNCITRAL Model Law on Cross-Border Insolvency (Model Law) aims at ensuring coordination and cooperation between the official bodies of insolvency proceedings commenced in various countries. As at the time of writing, the Model Law has been adopted by 51 States in a total of 55 jurisdictions. Although Belgian law has included some of the provisions of the Model Law in Book XX, Title VII, Chapter II of the Belgian Code of Economic Law (CEL), it has not expressly adopted the Model Law.

A significant limitation of the Model Law is that it does not lend itself to any type of centralised insolvency proceedings. Another limitation of the Model Law in the context of an enterprise group is that there is no recognised legal framework to assist in the implementation of any reorganisation.

In addition, the UNCITRAL Model Law on Enterprise Group Insolvency (MLEGI) focuses on cooperation, coordination, and communication in the context of an enterprise group situation and the appointment of a group coordinator.

Secondly, in the European context, article 41 *et seq.* of Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (EIR Recast) provides for the coordination of main and secondary proceedings, and article 56 *et seq.* of the EIR Recast deals with the coordination of two or more members of a group of companies and the appointment of a group coordinator. Both instruments regulate the cooperation and communication between IPs and courts. In Belgium, the relevant provisions of the EIR Recast have been included in Book XX, Title VII, Chapter I of the CEL. Article XX. 206 of the CEL provides that a foreign IP must be represented by a lawyer in Belgium.

By coordinating the proceedings of a company group, this, in principle, should reduce the costs and the possibility of conflicts of interests betweendifferent IPs for the benefit of equal treatment of all creditors and stakeholders. Article 56 of the EIR Recast contains an obligation for an IP appointed in proceedings concerning a member of a group to cooperate with any IP appointed in proceedings concerning another member of the group. Robert Van Galen comments in his book, *An Introduction to European Insolvency Law*, that IPs of a company may assert competitive claims in insolvency proceedings of other members of the group, which qualifies or imposes conditions on the obligation to cooperate, especially where there are conflicts of interest between creditors of group companies.[5]

In addition, an IP's obligation to cooperate as provided for in article 56 of the EIR Recast, in the case of group companies, limits this cooperation to the extent that: (i) it is appropriate to facilitate the effective administration of those proceedings; (ii) it is not incompatible with the rules applicable to such proceedings; and (iii) it does not entail a conflict of interest. Further, the cooperation may take any form, including the conclusion of agreements and protocols.

According to Book XX, Title VII of the CEL, Belgian IPs of main or territorial proceedings and courts have a general duty to cooperate and to communicate information to the IPs of foreign insolvency proceedings or to foreign courts. Courts

[5] R Van Galen, *An Introduction to European Insolvency Law* (Wolters Kluwer, 2021) 91, 203.

can only refuse to provide information to a foreign court for serious reasons.[6] In addition, Belgian courts need to record to whom and what information has been provided.[7] The same obligations apply where bankruptcy proceedings have been opened regarding companies of the same group.[8]

Protocols dealing with cooperation or coordination in cross-border matters can be useful, but language and applicable substantive laws require careful consideration, especially as some terms in common usage, such as "lien", have significantly different meanings in different jurisdictions.[9] Cross-border protocols are very commonly used between the US, Canada and the United Kingdom (UK), but to a lesser extent in civil law countries such as Belgium or under the EIR Recast in general. The use of insolvency protocols is promulgated in several non-binding instruments and best practices. The signing of an insolvency protocol may be justified in situations where, prior to insolvency, group entities operated as a single economic enterprise. This can be determined by or result from an integrated business model, close operational and financial ties facilitated by intra-group financial arrangements (e.g. intra-group loans, cross-guarantees and cash pooling), centralised data management and decision-making.

An opportunity to use such a protocol in an international case was missed in the matter regarding *Antwerp Bulkcarriers*,[10] which involved a Belgian company facing insolvency proceedings in Belgium. The American stevedores attached a lien to one of the company's ships under US maritime law. The ship then sailed to Canada where the stevedores opened a Canadian admiralty proceeding. The Belgian administrator sought for the ship to be turned over to him. The Canadian Supreme Court denied the Belgian administrator's application, the reason being that foreign bankruptcy law should "faithfully mirror the provisions of Canadian bankruptcy law", according to which "protection of secured creditors is a strong public policy in Canadian bankruptcy schemes."[11] In a parallel case of *Holt Cargo Systems*,[12] the Supreme Court in Canada ruled that "the need for such international cooperation in bankruptcy and insolvency has been evident for a very long time" but that "only some of the key components of the universalist approach have been reflected in Canadian law." The latter decision led Professor Doctor Reinhard Bork to conclude that international coordination is an important factor but is not necessarily a controlling factor.[13]

1.1 Corporate group versus individual legal entity

1.1.1 The insolvency and restructuring systems that are in force

European as well as Belgian legislation defines a group of companies as a parent undertaking with all its subsidiary undertakings.[14]

Each company is distinct from its members and in case of insolvency or a restructuring procedure, the separate and distinct legal personality of each individual company

[6] CEL, art XX.219, § 3.
[7] *Idem*, arts XX.218, XX.209.
[8] *Idem*, art XX.218.
[9] Kokorin and Wessels, above n 1, 186-187.
[10] *Antwerp Bulkcarriers N.V.v Holt Cargo Systems, Inc.* [2001] 3 SCR 951.
[11] Reinhard Bork, *Corporate Insolvency Law, A Comparative Textbook* (Intersentia, 2020) 231–232.
[12] *Holt Cargo Systems Inc. v ABC Containerline N.V. (Trustee of)* [2001] 3 SCR 907.
[13] Bork, above n 11.
[14] CEL, art I.22, 25º; EIR Recast, art 2(13).

within a "corporate group" is respected under European and Belgian law. The Belgian courts are generally reluctant to "pierce the corporate veil" to make the individual members or other group companies liable for the debts or the actions of the company in default, except in case of fraud and intermingling of company goods.

For article 492*bis* of the Belgian Criminal Code on abuse of company goods to apply, the following conditions must be complied with: (i) use of the goods or the credit of a civil and commercial company as well as a non-profit organisation; (ii) with a fraudulent intent and for personal use, direct or indirectly; and (iii) knowingly that by doing so such actions are significantly detrimental to the capital interest of the legal person and those of its creditors or shareholders.

A legal entity must be distinguished from its individual members and the fact that one shareholder owns all of the shares in a company does not mean the shareholder cannot be held guilty of a crime of abuse of company goods. The *ratio legis* behind it is to protect and provide legal certainty to third parties contracting with the legal entity. The approval by the general shareholders' meeting cannot be used as an argument for the criminal sanctions not to apply. It should, however, be noted that, under the principles of the law of torts, a parent company may in certain circumstances be liable in respect of its actions towards its subsidiary in the event the parent company is using its subsidiary only for its own corporate benefit.

To put a "group" of companies into an insolvency process, separate insolvency proceedings must be commenced in respect of each individual company. However, different forms of insolvency proceedings may apply to each company within the group, and similarly different IPs may still be appointed to each company.

1.1.2 Definition of a corporate group

A group undertaking is defined in article I.22, 25º of the CEL for the purpose of Book XX of the CEL dealing with company insolvencies.

In practice, there are different types of group companies, namely with either a horizontal or a pyramid form of ownership. The type of effective control can be centralised or decentralised and hierarchical.

As indicated, the Belgian legal system is based on the individual legal entity concept, independent of the type of control that exists within a group, which is often in contrast with the economic reality of the group context and group interest because the legal system is constantly challenged and coming under pressure. For example, what about the intra-group guarantees provided during a claw-back period? A judge needs to decide in each individual case whether such guarantees have been provided at arm's length and whether the corporate interest of the individual entity is aligned with the interest of the group.

When such guarantees are granted upstream to the detriment of the creditors of the local subsidiary, they may become problematic. The Belgian High Court (*Cour de Cassation-Hof van Cassatie*) decided that the Court of Appeal had correctly judged that the simple fact that a company belongs to a company group is not sufficient to conclude that the general interest of the group is sufficient to deduce that the collateral has not been provided for free.[15] In another matter, the Belgian High Court

[15] Cass. 9 March 2000, *TBH* 2000, 782, with note C.-A. Leunen.

decided that the costs of the IP of the controlling mother entity for the sale of the assets of the daughter company could be considered a debt of the bankrupt estate of the mother entity.[16]

Nevertheless, Professor Eric Dirix has commented in the past that Belgian case law could be more creative in defining corporate group interests,[17] in the absence of which specific legal provisions would be more than welcome.[18] Currently, the debate is being handled between the proponents of "enterprise principles" and of "entity of law." Under the first theory, one is of the opinion that, in certain circumstances, the relationship among group members should take priority.

1.1.3 Legislation relating to corporate groups

There are currently no draft company or insolvency laws in Belgium which would provide for a group insolvency or restructuring proceeding other than the concept of a "group coordination plan" under the EIR Recast in a European context and implemented in Book XX of the CEL.

1.2 Corporate group versus individual corporate benefit

1.2.1 The existence and relevance of "corporate group benefits"

The benefits of a corporate group are multiple, as there is simplified access to finance, intra-group financing or leveraging of collateral, market and product diversification, easier access to labour and raw materials, and interrelationship of technology and knowhow.

However, there are also risks involved. A considerable risk for individual group company directors stems from entering into guarantees or providing collateral covering obligations of a parent or other group company that exceed the individual group company's capabilities or that are not considered to be entered into at arm's length from the individual group company's point of view. For example, the enforcement of a guarantee or collateral by a company for the benefit of another group company should never result in the net assets of the individual group company falling below half of its share capital.

Downstream guarantees and provision of collateral can be assumed to be for the direct or indirect benefit of the mother entity in the form of profit distribution / dividends or the like. While generally accepted, it must be assessed each time whether it is for the effective benefit of the mother entity. Cases whereby there was never a dividend or where the profits are distributed elsewhere (for example, through intercompany liens) may still lead to a judge holding that the downstream guarantee was not for the benefit of the mother entity. Moreover, for upstream or cross-company guarantees and provision of collateral, one cannot make a general assumption. A benefit could exist for the subsidiary in providing less expensive finance for the subsidiary through group borrowing with on-lending from the borrowing entity to the

[16] Cass. 4 February 2005, *TRV* 2006, 601 with note J. Vananroye and A. de Wilde.
[17] E Dirix, "Heeft het privaatrecht nog een toekomst?" in C van Schoubroeck, W. Devroe, K. Geens and J. Stuyck (eds), *Over grenzen, Liber Americorum Herman Cousy* (Intersentia, 2011), 807, 809.
[18] A Van Hoe, "*Funktionswandel* in het groepsrecht: De (on) mogelijkheid tot vereenzelviging van groepsvennootschappen" in *De vennootschapsgroep in de greep van het recht* (Intersentia, 2013) 1–21.

subsidiary. This will need to be evidenced or explained in corporate decision documentation.

Under Belgian law, there is no legal prohibition on upstream or cross-company guarantees by subsidiaries. However, as with all acts by a company, the granting of such a guarantee or collateral must be for the corporate benefit of the individual company and always at arm's length. The Belgian approach to intra-group transactions, and in particular upstream guarantees, is largely derived from the case law of the French *Cour de Cassation* in the *Rozenblum* matter.[19] Such operations are permitted subject to the following conditions:

- the company granting the guarantee must enjoy an effective benefit from the operation.

  In case of an upstream guarantee, this condition is almost always only fulfilled if the company has received an effective financial advantage of the granting of such a guarantee. For example, in the form of an advantageous interest rate on intra-group credit that is (in)directly granted by the borrower under the secured credit facility (at least as compared to the best interest rate the subsidiary would have been able to agree on the market under reasonable conditions);

- the operation must not disrupt the balance between the respective commitments made by the various group companies in the interests of the group.

  In respect of upstream guarantees, the achievement of this condition is most at risk if some group companies take on a portion of the risk that is manifestly not in proportion to: (a) the portion of the risk other group companies take on in the transaction; and (b) the distribution of the benefits of the transaction between the group companies; and

- the operation must be within the financial capabilities of the individual group company

  This condition essentially concerns the balance between the commitments entered into by the group company in comparison with its individual financial resources. If the former clearly outweigh the latter, this condition is not met.

  For upstream guarantees, this is assessed from a review of the individual group company's assets versus its liabilities prior to the transaction and in particular the individual group company's balance sheet. As a rule of thumb, the various financing ratios of the individual group company must not suffer dramatically considering various scenarios following the transaction on the assets and liabilities side (compared to similar other scenarios such as external financing by the individual group company itself).

In addition to these conditions, the operation must also be in scope of the individual group company's object and within its corporate purpose.

If any of the preceding conditions are not met, the validity of the operation (in this case the granting of the guarantee or collateral) may be challenged by any interested party in a bankruptcy of the individual group company.

[19] Cass. Crim. 4 February 1985, Droit pénal des affaires, Précis Dalloz, Wilfrid Jeandidier & Xavier Pin.

1.2.2 Director liability

A negative impact of the corporate group benefit on the corporate benefit of the individual group company, or the risk of being dragged into the insolvency of another group company due to the provision of excessive guarantees or collateral, can be somewhat reduced by the inclusion of standard contractual clauses in the loan and other commercial agreements wherein individual group companies provide guarantees or collateral for the benefit of the other group companies (although there is no specific case law on point). In general, the conditions are stricter for upstream than for downstream guarantees or provision of collateral.

The Belgian standard limitation wording, so that an upstream or downstream guarantee would be considered at arm's length, reads as follows:

- The total liability of any Guarantor having its statutory seat in Belgium (a Belgian Guarantor) under the Guarantee and Indemnity Clause shall at all times be limited to the extent it would not constitute unlawful financial assistance for its own share acquisition in accordance with article 5:152 or article 7:227 (as the case may be) of the Belgian Code of Companies and Associations (CCA).

- Notwithstanding anything set out to the contrary in this Agreement or any other Finance Document, the aggregate of the obligations of any Belgian Guarantor under this Guarantee and Indemnity Clause will at all times be limited to an amount equal to the higher of:

  i. the highest level of On-Lending to such Belgian Guarantor and its Subsidiaries reached at any time between the date of this Agreement and the date on which a demand is made on such Belgian Guarantor under the Guarantee and Indemnity Clause;

  ii. ninety per cent (90%) of the net assets of such Belgian Guarantor calculated on the basis of the latest available audited annual accounts at the date of accession to this Agreement; and

  iii. ninety per cent (90%) of the net assets of such Belgian Guarantor calculated on the basis of the latest audited annual accounts available at the date on which a demand is made on it under the Guarantee and Indemnity Clause.

  For the purposes of this Clause:

  - net assets means, in relation to a Belgian Guarantor (irrespective of its legal form), netto actief / actif net as determined in accordance with article 5:142 or article 7:212 (as the case may be) of the Belgian CCA to determine whether a dividend can be distributed and the Accounting Principles, but not taking intra-group debt into account for the purpose of calculating the relevant Belgian Guarantor's net assets and, in the event of a dispute on the amount of net assets, a certificate of such amount from the statutory auditors of that Belgian Guarantor (or, if no statutory auditor is appointed or the statutory auditor refuses to issue such certificate, from an accountant appointed upon the Security Agent's request by the Instituut van Bedrijfsrevisoren / Institut des Réviseurs d'Entreprises) shall be conclusive, save in case of manifest error; and

  - On-Lending means the aggregate amount of all financial indebtedness made available by a member of the Group, directly or indirectly, to such Belgian Guarantor or any of its Subsidiaries (in each case, irrespective of whether retained or on-lent by such Belgian Guarantor or the Subsidiary in question), it being understood that the amount of such financial indebtedness will only be counted once when calculating the aggregate amount.

- Notwithstanding any provision to the contrary, to the extent any Belgian Guarantor guarantees the obligations of a (direct or indirect) Subsidiary, the limitations set out above shall not apply.

Where the Belgian guarantor has employees, as a rule of thumb the maximum security should be 75% instead of 90% of the net assets mentioned above. The reasoning behind this is that it is deemed likely that 25% would be needed to pay prioritised redundancy fees, social security and taxes related to the salaries in the event of the bankruptcy of the Belgian subsidiary.

The provision of such limitation wording in the agreements, although not based on case law or legislation, avoids to a certain extent the imbalance between the efforts of the individual group companies compared to the actual group benefit.

In addition, the board of directors of the individual group companies, when entering into agreements which are not necessarily directly to the corporate benefit of the individual group company, must deliberate on the subject matter in a board meeting weighing up the pros and cons of entering into such arrangements and include this in the minutes of their board meeting. For listed companies, whereby the enforcement of such guarantees or collateral can result in a change of control triggering a mandatory public offer, a decision of the shareholders' meeting and a publication in the Belgian Official Journal is required.[20]

The directors' liability is inevitably triggered one way or another in cases of abuse. The UNCITRAL Legislative Guide on Insolvency Law addresses the obligations of directors of an individual company in the period approaching insolvency and develops the directors' liability further in the context of enterprise groups. In addition, it considers the situation where a director holds a managerial or executive position in more than one group member and conflicts arise in discharging the obligations owed to the different members.

1.2.3 *"Early warning systems"*

The directors of a Belgian company limited by shares (*naamloze vennootschap / société anonyme*) have to convene a special general meeting of the shareholders if, as a result of the losses incurred, the net assets of the company drop below half the company's share capital, and they must either liquidate the company or take other measures, such as increasing the share capital.[21] Such a meeting must be convened no later than two months after the losses are established unless the company's Articles of Incorporation provide stricter terms. The directors must provide a special report to the shareholders 15 days prior to the general meeting of the shareholders.

[20] CCA, art 7.151.
[21] CCA, art 7.228.

In cases where the net assets of the company have dropped below one-quarter of the company's share capital, the company must be liquidated if the decision is approved by one quarter of the shares represented at the shareholders' meeting.

Not identical but similar provisions apply to a private limited company (*besloten vennootschap / société à responsibility limitée*),[22] where the early warning system already operates when there is a risk of negative equity. A failure to do so, in both types of companies, results in the legal assumption that all third-party damages are the result of the failure to convene such a special shareholders' meeting, and it could trigger directors' personal liability.

In addition, companies that fail to file their annual accounts with the National Bank of Belgium (NBB) within the mandatory delay of seven months after the closing of their annual accounting year, as provided by the CCA, can be forced by the public prosecutor, any interested third party or the office of the enterprise court to liquidate the company by law, and a mandatory liquidator can be appointed. In each case a period of grace is provided for a possible remediation,[23] but the objective is that negligent companies which obstruct the good functioning of the legal system, avoid transparency and block control are being sanctioned.

In addition, when important and concordant facts can affect the continuity of the economic activity of the enterprise, an external accountant or auditor can inform the board of directors in writing, explaining his or her concerns. If the company through its board does not within 30 days provide the necessary measures to safeguard the continuing of the company during the upcoming 12 months, the auditor can inform the court in writing.[24]

In each judicial district, the Chambers for Companies in Distress (*Kamers voor Ondernemingen in Moeilijkheden / Chambres des entreprises en difficulté)* are constantly monitoring companies in financial distress. The office of the enterprise court where the debtor has its centre of main interests (COMI) is responsible for collecting all information on a company in financial difficulties which could impact on the continuity of the business.[25] The information consists of contested letters of exchange or promissory notes, judgments by default, and delay in payments of social security and taxes.[26] The Chambers for Companies in Distress can do this themselves or appoint a reporting judge for a period of eight months, which can be extended for another 10 months. They can hear the debtor in chambers, request additional information and, if the conditions are met, declare the debtor or company bankrupt or file for liquidation. The public prosecutor and debtor has access to the file kept with the Chamber for Companies in Distress.[27]

1.2.4 Pending or draft legislation

There is no pending or draft legislation on these issues.

[22] CCA, art 5.153.
[23] CCA, art 2.74.
[24] CEL, art XX.23 § 2.
[25] CEL, art XX.21.
[26] CEL, arts XX.22, 23.
[27] CEL, arts XX.25–29.

1.3 Universalism versus territorial principle

1.3.1 Application of the modified universalism rules

Historically, the Belgian legal system as developed by case law has always been in favor of universalism (universality) and the creation of one unified bankruptcy estate with a worldwide scope and one set of proceedings opened against an insolvent debtor (unity). However, in legal practice these rules often remained without effect regarding assets in foreign countries. If a foreign bankruptcy judgment does not have an extra-territorial effect, a Belgian judgment may not give universal effect to such a bankruptcy judgment.[28] In other words, Belgium universalism has always been constrained by the limitations of the scope of the foreign bankruptcy judgment.[29]

Since the entering into force of Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings (EIR) and the EIR Recast, which apply to all Member States of the European Union (EU) except Denmark, a modified universalism has been installed regarding main and secondary proceedings.

Main insolvency proceedings can be opened in a EU Member State[30] when the debtor's COMI is in that Member State, and these proceedings will extend to assets situated in other EU Member States, except those where secondary proceedings have been opened.

Secondary insolvency proceedings can be opened in the other EU Member States where the debtor has an establishment within the meaning of article 2(10) of the EIR Recast, but importantly, these proceedings are confined to local assets.

In cases where the EIR Recast does not apply, the Belgian Code on Private International Law (PIL Code)[31] has installed a similar sort of modified universalism different from the previous historic universality-based system, which is now also included in Book XX, Title VII of the CEL. Third-country insolvency proceedings must be recognised in Belgium in accordance with the PIL Code. The purpose of Chapter XI of the PIL Code is in fact also to expand the European rules under the EIR Recast in relation to third countries as much as possible, considering the previously mentioned uncertainty in those jurisdictions about reciprocity and willingness to cooperate.

Belgian law has therefore abandoned the principles of unity and universality. Thus, in accordance with the EIR Recast, the PIL Code and Book XX, Title VII of the CEL, Belgian law has adopted the "limited universal" approach, which allows for the opening of territorial proceedings concurrent with universal proceedings under all circumstances. Foreign insolvency proceedings no longer prevent a Belgian court from opening territorial proceedings when the debtor has an establishment in Belgium.[32] The reason for this change was the lack of reciprocity and the opening of parallel proceedings, for example in the *Lernout & Hauspie Speech Products NV* case, which raised questions in the Belgian Parliament regarding the territorial approach of countries such as the US.[33]

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[28] Cour de Cassation, 26 September 1991, *R.D.C.,* 1992, page 360.
[29] Ivan Verougstraete, *Manuel de la faillite et du concordat*, Kluwer, 1998, 613–646.
[30] EIR Recast, art 3(1).
[31] Law 16 July 2004: re the PIL Code, see *Belgian Official Gazette* 27 July 2004.
[32] PIL Code, art 118 §1, 2º.
[33] Eric Dirix and Vincent Sagaert, *Cross-border Insolvency in Belgian Private International Law* (John Wily & Sons Ltd, 2006) 60.

The jurisdiction rules for main and territorial proceedings are of public order, and the parties cannot contractually provide otherwise.

Pursuant to article 121, §1 of the PIL Code, third-country judgments concerning main insolvency proceedings that do not fall within the scope of the EIR Recast are recognised or declared enforceable in Belgium if the judgment was given by a court in the state in which the debtor's COMI was situated when those proceedings were instituted. They can, however, have no effect detrimental to certain protective provisions determining the applicable law for:

- acts detrimental to the creditors as a whole;
- real estate assets owned by the estate;
- assets on financially regulated markets;
- employment agreements;
- registered assets; and
- certain ongoing litigations.[34]

The enforcement of third-country judgments is not automatic under Belgian law.[35] Therefore, a petition for enforcement (*exequatur*) will have to be brought before the Belgian courts in accordance with article 23 of the PIL Code. Pursuant to article 25 of the PIL Code, recognition may be refused on certain grounds, the most notable of which are: (i) manifest incompatibility with Belgian public policy; (ii) violation of rights of defence; and (iii) the fact that the foreign judgment is still subject to an ordinary appeal.

Pursuant to article 121, §3 of the PIL Code, the bankruptcy trustee appointed by a third-country court shall henceforth be recognised as the representative of the foreign bankrupt estate. The trustee will be entitled to exercise the competences he / she received with his / her appointment as bankruptcy trustee in accordance with the third-country law, although articles XX.206 and XX.215 of the CEL provide that the IP must be represented by a lawyer in Belgium.

There is little published case law on the recognition of third-country insolvency proceedings in Belgium. A landmark case in the Netherlands, however, shows that the recognition and enforcement of Russian insolvency proceedings in the EU is not self-evident. In the admittedly complex and controversial *Yukos* case, the Dutch courts not only reviewed procedural safeguards and parties' rights in the insolvency proceedings themselves but also considered substantive matters leading up to the bankruptcy of the Russian company concerned.[36]

Regulated entities such as insurance undertakings, credit institutions and collective investment undertakings do not fall within the scope of the EIR and the EIR Recast and have not been discussed for the purpose of investigating whether substantive consolidated insolvency proceedings would be possible.

[34] PIL Code, art 121, §2.
[35] PIL Code, art 22.
[36] See: https://uitspraken.rechtspraak.nl/inziendocument?id=ECLI:NL:HR:2019:54.

1.3.2 Bilateral and / or multilateral treaties in force

Historically, Belgium has concluded the following bi-lateral treaties: with France dated 8 July 1899;[37] and with the Netherlands dated 28 March 1925[38] and Austria dated 16 July 1969[39]– both of which became obsolete due to the coming into force of the EIR and the EIR Recast.[40]

Belgium has never concluded any other bilateral or multilateral treaties in relation to these issues.

1.3.3 Pending legislation

There is no pending legislation in relation to these issues.

1.4 Competent court and applicable law

1.4.1 Applicable law that falls outside of the lex fori concursus and related issues

The international conflict of law rules of the Belgian PIL Code mirror those in the EIR Recast.[41] The basic rule is the application of the *lex concursus,* which means that Belgian insolvency legislation determines the opening of insolvency proceedings by the Belgian courts, their conduct and their closure. Article 119, §1 PIL Code refers expressly to article 7, §2(a)–(m) of the EIR Recast. Article 199, §2 of the PIL Code, regarding third countries, provides for the same exceptions to the scope of the *lex concursus,* as in the case of the EIR Recast: namely regarding the rights *in rem* of third parties (1°) and retention of title (3°). This is, however, without prejudice to the rules of the *lex concursus* on avoidance actions.

Rights *in rem* to an asset are generally governed by the law of the country in which the assets are located when they are invoked.[42] This law also determines the priority ranking and the distribution of the proceeds of the realisation of the assets.[43] However, specific rules are set up for rights *in rem* on specific categories of assets. Regarding the rights of set-off, article 119, §2, 2° of the PIL Code provides that the effects of the opening of insolvency proceedings on the right of the creditor to rely on set-off of his or her claim against the claim of the debtor are governed by the law applicable to the insolvent debtor's claim. Under article 14 of the Belgian Law of 15 December 2004 concerning financial collateral arrangements, the right of set-off is also allowed after the opening of a bankruptcy proceedings.[44]

[37] Agreement dated 8 July 1899 between Belgium and France on jurisdiction, authority and enforcement of judgments, arbitration awards and valid instruments, *Belgian Official Gazette*, 30 July 1900.
[38] Law of 28 March 1925 approving the Brussels Convention, concluded on 28 March 1925, as well as the additional Protocol signed the same day between Belgium and the Netherlands on the territorial jurisdiction, on bankruptcy and on authority and enforcement of judicial decisions, of arbitral statements and authentic deeds, *Belgian Official Gazette*, 27 July 1929.
[39] Agreement dated 16 July 1969 between the Kingdom of Belgium and the Republic of Austria on bankruptcy, settlement and suspension of payment, *Belgian Official Gazette*, 24 July 1975**.**
[40] EIR Recast, arts (1)(a), (1)(b) and (1)(c).
[41] E Dirix and V Sagaert, "Cross-Border Insolvency in Belgian Private International Law" (2006) 15 *International Insolvency Review*, 66–67.
[42] PIL Code, art 87, §1.
[43] PIL Code, art 94, § 2.
[44] *Belgian Official Gazette,* 1 February 2005.

Because of the similarity to the exceptions of the *lex concursus* under the EIR Recast and the PIL Code when third countries are involved, the conclusion on the applicable law should not have an impact on the outcome of our analysis here below as to whether group consolidation or synthetic restructuring proceedings are possible.

1.4.2 *Harmonisation of substantive restructuring and insolvency laws*

At a European level, since 2010 several initiatives have been taken to further harmonise the substantive legislation in the different EU Member States[45] and to facilitate cross-border group restructurings in the framework of the European Capital Markets Union. Also, the cost benefit of such harmonisation in the cross-border context is being reviewed.

In the first report of INSOL Europe on the topic of harmonisation of insolvency laws at a European level, among the fields eligible for harmonisation were identified as:

- the eligibility and criteria for the opening of an insolvency proceeding;
- the general stay in the creditors' powers to assert and enforce their rights after the commencement of insolvency and reorganisation proceedings;
- the rules with respect to the management of the insolvency proceedings;
- the ranking of creditors;
- the rules on the process of filing and verification of creditors' claims;
- the responsibility for the proposal, verification, adoption, modification and contents of reorganisation plans;
- the scope of the insolvency estate;
- the rules on the annulment of transactions entered into prior to the opening of the insolvency proceedings (avoidance actions);
- the termination of contracts and the rules as to the performance of contracts;
- the liability of directors, shadow directors, shareholders, lenders and other parties involved with the debtor;
- the provision of post-commencement finance;
- the practitioner's qualifications and eligibility for the appointment as insolvency representative, different rules regarding licensing, regulation, supervision and professional ethics and conduct;
- the coordination of insolvency proceedings with respect to companies belonging to a group of companies;

[45] See: https://www.europarl.europa.eu/meetdocs/2009_2014/documents/empl/dv/empl_study_insolvencyproceedings_/empl_study_insolvencyproceedings_en.pdf.

- the need for a EU database of court orders and judgments; and
- the scope of the EIR at the time.

Some of the suggestions were finally included in the Resolution of the European Parliament of 15 November 2011 with recommendations to the Commission on insolvency proceedings in the context of EU company law.[46]

Some of the objectives, for example the coordination of insolvency proceedings with respect to companies belonging to a group of companies, have been included in Chapter V of the EIR Recast.

In 2019, a Directive was adopted on preventive restructuring frameworks, discharge of debt and disqualifications and measures to increase efficiency concerning procedures for restructuring, insolvency and discharge of debt.[47] It established minimum standards for: (i) preventive restructuring procedures available for debtors in financial difficulty when there is a likelihood of insolvency; (ii) procedures leading to a discharge of debts incurred by over-indebted entrepreneurs and allowing them to take up a new activity; and (iii) targeted rules on increasing the efficiency of all types of insolvency procedures, including liquidation procedures.

However, this Directive did not harmonise the core aspects of substantive insolvency law, such as a common definition of insolvency, the conditions for opening insolvency proceedings, the ranking of claims, avoidance actions and the identification and tracking of assets belonging to the insolvency estate, which to a large extent remains the competence of the EU Member States. Vast differences in the insolvency frameworks of EU Member States, where no two systems are alike, thus continue to exist.

1.4.3 *Applicable treaties and case law*

These matters are discussed above.

1.4.4 *Upcoming new legislation*

Inefficient insolvency proceedings can delay the recovery of value and the restructuring of corporate assets and liabilities with negative knock-on effects for productivity, jobs and growth. Furthermore, the efficiency of insolvency proceedings is one of several key criteria for investors to decide whether to make cross-border investments. More efficient and predictable insolvency frameworks and enhanced confidence in cross-border financing would help strengthen capital markets in the EU and thus become a stepping-stone towards completing the European Capital Markets Union.

In the new Capital Markets Union Action Plan adopted on 24 September 2020, the European Commission announced that, to make the outcomes of insolvency proceedings more predictable, it will take a legislative or non-legislative initiative for

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[46] 2013/C 153 E/01. See: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A52011IP0484.

[47] Directive (EU) 2019/1023 of the European Parliament and of the Council of 29 June 2019 on preventive restructuring frameworks, discharge of debt and disqualifications, and measures to increase the efficiency concerning of procedures restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132, OJ L 172, 26 June 2019, 55.

minimum harmonisation or increased convergence in targeted areas of non-bank insolvency law.

In the framework of this European initiative for increasing convergences of national insolvency laws and to encourage cross-border investment, an expert working group at the European Commission is currently drafting legislation harmonising the following topics:

- procedural rules for the opening of insolvency procedures;
- ranking of claims;
- asset-tracing;
- avoidance actions; and
- directors' liability and professional qualifications / judicial training.

This work is still in a preliminary stage. A first draft will become available in the second quarter of 2022.

2. Substantive consolidated restructuring proceedings versus synthetic group restructurings proceedings

The EIR Recast introduced the concept of a "group coordination plan", a new chapter aimed at addressing corporate groups and the appointment of a group coordinator, which must be read as a step towards procedural coordination in line with the recommendations of the MLEGI, and which may or may not include synthetic group restructuring proceedings as an option for the adopting country.[48]

Where more than one member of the group is in an insolvency proceeding, the legislation allows an officeholder to request the opening of group coordination proceedings. A "group of companies" is defined as a parent undertaking and its subsidiary undertakings. The group proceeding is voluntary, and officeholders may object to being included as part of the coordination proceedings. Where a company / officeholder has opted in, the officeholder is only required to consider the coordinator's recommendations and the content of the group plan with no obligation on the officeholder to follow the plan. But, if an officeholder opts out of the coordination plan, they must provide reasons for opting out. When opening group coordination proceedings, the courts will consider whether any group member might be financially disadvantaged by taking part and whether it is appropriate to proceed with a group plan.

So far, this option seems not to have been used in practice. Reference in this regard can be made to the 2021–2022 Statement from the Conference on European Restructuring and Insolvency Law (CERIL), whereby the CERIL identified the fact that the EU "group coordination proceedings" system is not used in practice, resulting in inefficient administration of insolvency proceedings relating to different companies forming part of a group of companies.[49]

[48] EIR Recast, art 61 *et seq*.
[49] See: https://www.ceril.eu/news/ceril-statement-2021-2-on-eu-group-coordination-proceedings.

However, while substantive consolidated group proceedings are not yet admissible under European or Belgian law, synthetic consolidated group restructurings can indeed work and have been used in practice, although while still respecting the single entity approach. This practice was first developed regarding secondary proceedings[50] in different EU Member States. Articles XX.204 and XX.213 of the CEL provide for the right of the IP of the main proceeding to give certain undertakings to avoid opening secondary insolvency proceedings. This must be done in writing and in the language of the local proceeding.

Hence the question arises whether such synthetic bankruptcy proceedings are admissible in a group context and in countries such as Belgium, where there exists a mandatory obligation to file for bankruptcy.

A bankruptcy situation arises when: (1) the company has stopped making payments when these fall due (*staking van betaling / est en état de cessation de paiement)*; and (2) the company is unable to attain further financing, including deferment of payment by its creditors (loss of creditworthiness: *geschokt krediet / credit ébranlé*). A company is deemed to have generally lost all creditworthiness when it can show that it cannot receive credit on the market (typically with financial institutions) at reasonable conditions for an amount that is sufficient to pay the company's debts.[51] A Belgian company that meets the two criteria set out above is under a legal obligation to file for bankruptcy within one month from the time when these conditions are first met.[52] Failure to make the appropriate filings exposes the board of directors to both civil and criminal liability. A timely filing, on the other hand, does not necessarily shield directors against liability.

The concept of "synthetic proceedings" was first introduced by British courts in the mid-2000s. The High Court of Justice in Birmingham ruled in 2005 that the (British) joint administrators of the MG Rover Group

> "may make payments to the [foreign] employees of the company, such that they receive the same monies as the employees would receive if secondary proceedings were commenced … provided that the administrators think the making of such payments is likely to assist achievement of the purpose of administration."

While the court could not expect to outright prevent the potential opening of secondary proceedings, it hoped at least

> "that by this means courts in other member states may come to appreciate that the principal objective of the administration is to rescue the relevant national sales company as a going concern, and if that is not reasonably practicable (or would not achieve the best result for the company's creditors as a whole) then to achieve a better result for that national sales company's creditors as a whole than would be achieved by an immediate winding up."[53]

[50] R Arts, "Main and Secondary Proceedings in the Recast of the European Insolvency Regulation: The Only Good Secondary Proceeding is a Synthetic Proceeding".
[51] CEL, art XX. 99.
[52] CEL, art XX.102.
[53] R Arts, above n 50.

This practice has been further developed by the English courts in cases such as *Re Collins and Aikman*.[54] In that case, the insolvency proceedings (administrations under the English Insolvency Act 1986) took place in respect of 24 companies, incorporated in 10 countries across Europe, which formed the European operations of the Collins & Aikman Group. The Collins & Aikman Group was a leading supplier of automotive components to the world's largest vehicle manufacturers. In May 2005, the US operations of the Collins & Aikman Group went into Chapter 11 proceedings in the US which put the European companies under severe financial pressure. On 15 July 2005, the 24 European companies applied to the High Court in England for administration orders to be made in respect of them, and the High Court made the orders sought the same day. The 24 European companies comprised six companies incorporated in the UK and 18 companies incorporated in other European countries. In relation to those of the companies incorporated outside England and Wales, the High Court made administration orders in respect of each of them on the basis that in each case the COMI, namely the head office function, for the purpose of article 3 of the EIR, was in England and Wales at the time.[55]

Because of the closely integrated group, from the outset of the proceedings, the administrators sought to adopt a unified approach to the continuation of the businesses, the funding of the administrations and the sale of the businesses and assets of the companies, in the firm belief that this approach would lead to the best possible return to creditors. It immediately became clear that there would be much greater chances of success in negotiating funding for the insolvency process and in selling the assets if this could be done on a group-wide basis rather than piecemeal on a company-by-company basis.

In the case of *Collins & Aikman*, the court therefore further developed the notion of "synthetic" secondary proceedings, holding that the UK Insolvency Act 1986 was sufficiently flexible for UK IPs to honour promises made to creditors in other EU Member States that local priorities would be respected in return for not opening secondary proceedings in these states. Local creditors effectively got the benefits of the secondary proceedings without the trouble of having to open them. These secondary proceedings were "synthetic" or "virtual" rather than actual.

The decision of the UK court was taken based on article 16.1 of the EIR[56] (current article 19.1 of the EIR Recast), providing that any judgment opening insolvency proceedings handed down by a court of a Member State which has jurisdiction pursuant to article 3 of the EIR Recast shall be recognised in all the other Member States from the time that it becomes effective in the state of the opening of proceedings.

Based on article 4.1 of the EIR (current article 7.1 of the EIR Recast), the law applicable to insolvency proceedings and their effects shall be that of the Member State within the territory of which such proceedings are opened.

Since the EIR did not include any provisions with respect to group companies, the insolvency procedure was opened in the UK on behalf of every company within the Collins & Aikman group, including Collins & Aikman Automotive Trim BVBA (the

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[54] [2006] EWHC 1343 (Ch).
[55] G Moss QC and T Smith, *Collins & Aikman*, International Case law Alert, No - v/2006, 11–31.
[56] OJ L 160, 30 June 2000, page 1.

Belgian legal entity) and local enforcement procedures subsequent to the opening of the insolvency procedure in the UK were therefore stopped.[57]

Following the *Collins & Aikman* example, in the *Nortel* case, the High Court of Justice Chancery Division agreed to the "sending of appropriate letters" to the courts of Member States in which secondary proceedings might be opened:

> "with a view to obtaining assistance from the courts of various Member States in the form of prior notification to the Joint Administrators of any request or application for the opening of secondary insolvency proceedings in those jurisdictions and the giving to the Joint Administrators of an opportunity to be heard on any such application. This is intended to enable them to explain to the relevant court why such proceedings would not be in the interests of the creditors."[58]

Hence, the question is, in the absence of any legal basis like the provisions in the EIR Recast, whether Belgian courts can be provided with sufficient comfort in order not to commence territorial proceedings as in the *Collins & Aikman* case. In addition, it is not at all certain whether a New York bankruptcy judgment taking a universalistic approach would be willing to open a bankruptcy proceeding regarding an individual group company in Belgium in a synthetic manner and whether a bankruptcy judge in a Belgian enterprise court would be willing to grant such a foreign judgment the same trust as it did in the *Collins & Aikman* case to a UK judgment, absent any legal basis.

In the *Exelco NV* matter, there was a clear refusal from the Belgian bankruptcy courts to collaborate with the Delaware bankruptcy courts since most of the assets of the Belgian entity were based in Belgium, and they declared the Belgian company bankrupt.

The underlying facts were as follows: Exelco, one of the oldest Belgian diamond distributors, a family-owned business, defaulted on its KBC USD 14 million loan. KBC's debt was secured by a pledge on the business and a guarantee from the group company and certain family members. When Exelco defaulted on the loan, KBC commenced a sort of involuntary insolvency proceeding in Belgium. Exelco North America Inc. and six related companies (the Belgian company among them) then commenced a Chapter 11 proceeding as a defence in Delaware. The latter proceeding was, however, dismissed by Judge Kevin Gross in the Delaware bankruptcy court, while recognising the Belgian bankruptcy proceeding based on Chapter 15 of the Bankruptcy Code. Although the issue of consolidated insolvency proceedings never came up, this more recent case shows the way of thinking of international bankruptcy judges.[59]

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[57] Judgment Court of Appeal Antwerp, dated 7 June 2006, GR 2005/AR/2521, in the matter Takata-Petri AG as plaintiff against Collins & Aikman Automotive Trim BVBA, defendant in the presence of Ford Werke Gmbh; Judgement of the Court of First Instance of the District Court of Tongeren (seizure), dated 19 August 2005, in the matter Collins & Aikman Automotive Trim BVBA as plaintiff against Takata-Pete Aktiengesellschaft defendant and in the presence of Ford Werke AG; Judgment of the District Court in 'Hertogenbosch dated 31 October 2005, Case no 1321/39/ KG ZA 05-645 with Simon Appell acting as administrator on behalf of Collins & Aikman Automotive Trim BV as plaintiff and Essent Netwerk BV as defendant.

[58] R Arts, above n 50.

[59] *Exelco NV.,* 17-bk-12029 (bankr.D.Del., 13 December 2017).

3. Duty to initiate insolvency process

The mandatory obligation to file for bankruptcy, and the impact of a guarantee from a foreign IP, is outlined in detail above. In relation to third-country bankruptcy judgments, national law applies (namely the PIL Code) and the question remains whether third-country judges and IPs can provide sufficient comfort to Belgian courts in order to refrain from opening additional legal proceedings.

4. Legal certainty and predictability

4.1 Legal certainty and predictability to local creditors

Legal certainty and predictability are key for all creditors, and it should be clear beforehand for any creditor what rank it will have in the event of the insolvency of a particular company. Creditors should be treated equally except in cases where legal priorities or contractual securities apply.

Local creditors when dealing with a company should know the applicable legislation and be able to check the company's financial position through the published financial accounts or other means of publication such as a national online pledge register or contested letters of exchange. Local creditors should not be taken by surprise by finding that a local company must pay under a guarantee or foreclose collateral for another group company without having received any benefit from the transaction concerned.

If the need is felt for the introduction of an exception from the insolvency ranking order, it should be granted only exceptionally and on well-founded grounds in a narrow way, for example, because it is essential for the success of a restructuring, or with the creditors' consent, or because of an avoidance action.

4.2 Communications with local courts and creditors

In cases where a main bankruptcy proceeding is opened in a third country and the bankruptcy judgment is recognised in Belgium, pursuant to article 121 of the PIL Code, an excerpt is published in the *Belgian Official Gazette* upon the request of the foreign IP.[60] Even if a third-country IP requests the recognition of a foreign proceeding in Belgium, this information will not be included in RegSol, the Belgian online insolvency register.

4.3 Guarantees by the IP in office

Except for the undertakings provided pursuant to article 36 of the EIR Recast, as implemented in article XX.204 of the CEL for European insolvency proceedings, by an IP to avoid secondary insolvency proceedings, Belgian law does not provide for similar guarantees for third-country IPs. However, the general liability rules continue to apply.

[60] CEL, art XX.213.

5. Consolidation of assets

5.1 Procedure with respect to the sale of the whole or part of a business

In Belgium, one IP could be appointed in different legal insolvency proceedings of companies of the same group, but even in the case of a sale of assets or a branch of activity of different group companies with respect to the proceeds, the separate legal entity approach must be complied with.

5.2 Difference in treatment with respect to tangible and intangible assets

Under Belgian law, there would be no difference in this regard.

5.3 Role of creditors and creditors' committees in a substantive consolidation

Since Belgian law does not recognise the concept of substantive consolidation, this question is otiose. In addition, the concept of creditors' committees does not yet exist under Belgian law.

5.4 Voting for or against a substantive consolidation

This topic is not applicable given the inapplicability of substantive consolidation in Belgium.

6. Equitable distribution and accountability of IP

Regarding this issue, no difference in treatment should be allowed by the IP regardless of the type of proceeding.

7. Intercompany claims

7.1 Order of priority

All creditors have an equal right to payment out of the proceeds of the individual debtor's estate distributed in proportion to their claims, and an exception to the rule can only be allowed in cases provided by law or agreement between the parties. Article 8 of the Belgian Mortgage Law provides for this *pari passu* principle.

In the *Private Equity Insurance Group* (C-156/15) case, the European Court of Justice decided with respect to article 20 of the Charter of Fundamental Rights of the EU that a difference in treatment under Directive 2002/47/EC on financial collateral arrangements was justified based on objective and reasonable criteria, namely that the difference relates to a legally permitted aim pursued by the legislation in question, and it is proportionate to the aim pursued by the treatment. As such, the exception to the *pari passu* principle does not breach the principle of equal treatment.

7.2 Concepts that can alter priority

Concepts such as equitable subordination and recharacterisation of debt are only allowed when provided by law or agreement between the parties concerned, since legal certainty amongst the creditors is key.

8. Administering a complex estate in one single consolidated procedure

Once again, reference must be made to the judgment of the English High Court rendered in the *Collins & Aikman* case. Following their appointment, the UK administrators traded the businesses of the companies (with the assistance of the funding support which was negotiated from the companies' customers) and, following a bidding process, successfully sold most of the business and assets of the companies to the benefit of all the stakeholders while still respecting the individual entity approach.

The case establishes a precedent that where, under the EIR, English main insolvency proceedings have been opened in relation to a foreign registered company, it is possible for foreign law distribution priorities to be applied indirectly by the English court to fulfil promises made by UK administrators to local creditors to persuade them not to cause secondary proceedings to be opened.

The important practical consequences of the decision are that, where main proceedings are opened in relation to a foreign company, an English administrator or liquidator can agree with local creditors to apply the relevant foreign law indirectly in the context of those proceedings and thereby avoid the need for secondary proceedings to be commenced to protect the priorities of local creditors. This may be of crucial importance where there is a group-wide insolvency, and there are significant benefits to be gained from there being a closely coordinated rescue, reconstruction, or insolvency main proceedings for group companies in the same jurisdiction, without the complication of secondary proceedings being opened in other Member States.[61]

In the Proposal of INSOL Europe on the Revision on the European Insolvency Regulation in May 2012, a suggestion for consolidated proceedings was made.[62] The idea was put forward that, regarding groups of companies, the COMI of the ultimate parent company is deemed to be COMI of the subsidiaries. The advantage would have been that in the event of group insolvency the court of the COMI would be able to safeguard the coordination of the main insolvency proceedings with respect to all the group companies and, secondly, the latter would in turn safeguard the application of the EIR then (the EIR Recast now) whenever the ultimate group COMI is located outside the EU.

A less drastic suggestion was made for a proposal of consolidated proceedings with no shift of the COMI in the sense that the subsidiary and its ultimate parent company both enter into insolvency proceedings, with the liquidator of the parent company being given powers similar to those that the liquidator in the main proceedings has *vis-à-vis* secondary proceedings, i.e. based on articles 27 *et seq.* of the EIR (articles 37 *et seq.* of the EIR Recast now).

None of the suggestions made by INSOL Europe were eventually taken up in the EIR Recast since they involved giving up legal sovereignty by EU Member States and their court systems, which was regarded as a step too far. In addition, with respect to third countries, going back in history to a universalistic approach is presumably an unachievable utopia.

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[61] G Moss QC and T Smith, above n 55, 11-31.

[62] R Van Galen, M Andre, D Fritz, V Gladel, F Van Koppen, D Marks QC and N Wouters, "Revision of the European Insolvency Regulation", Proposal INSOL Europe, 2012, 92-93.

9. Handling an insolvent parent with a healthy subsidiary

Whereas, throughout the lifetime of a company, it operates financially, administratively and commercially as a corporate group, at the time when a group runs into financial difficulties, it becomes clear that each legal entity is still treated as distinct from the other members of the group.[63]

Only exceptionally can solvent subsidiaries be called upon to contribute to the estate of the insolvent parent, or *vice versa*, to the extent that the company has provided guarantees or collateral for the benefit of the other company, but otherwise they would not be called upon to contribute. Moreover, these companies will only be asked to contribute when the guarantee or the collateral have been provided at arm's length and the companies have personally benefited from the transaction.

Otherwise, such transactions can be declared void. A parent company shareholder, like any other investor or creditor, may, however, be requested to convert an intra-group loan into equity or increase the capital of the subsidiary, especially under an alarm bell procedure, i.e. in case of negative equity, or a group rescue proceeding.

However, looking at a group from an eagle-eye perspective, as mentioned above, one may allow an IP of the group to restructure it while respecting the separate legal entities of the group and their individual creditors. The reason being that often one notices that in cases of insolvency of the mother entity the subsidiaries may shortly after run into financial difficulties if the group is not restructured in its totality.

[63] CCA, art I.22, 8º, XX.99.

BRAZIL

1. Consolidated group restructurings versus cooperation or coordination procedures

Federal Law No 11.101/2005 (Brazilian Bankruptcy Law), recently amended by Federal Law No 14.112/2020, regulates business insolvencies in Brazil. In addition to this, there are specific rules on civil insolvency proceedings, applicable to consumers and non-business entities, and on the insolvency of financial institutions, co-operatives and other entities, which are excluded from the scope of the Brazilian Bankruptcy Law.

Under the Brazilian Bankruptcy Law, there are three insolvency proceedings available: a court-supervised reorganisation proceeding (*Recuperação Judicial*); an expedited pre-packaged reorganisation proceeding (*Recuperação Extrajudicial*); and a bankruptcy liquidation proceeding (*Falência*).

The bankruptcy liquidation proceeding is designed for individual corporate entities, there being no provision under the Brazilian Bankruptcy Law for dealing with joint filing of bankruptcy liquidation proceedings of companies of the same corporate group. There are, however, rules preventing the extension of the effects of the bankruptcy liquidation proceeding to related entities. The Brazilian Bankruptcy Law allows the corporate veil of the debtor company to be lifted if there is abuse of legal personality, characterised by deviation of purpose or fraud, provided that the requirements set forth in the Civil Code and the procedural rules of the Code of Civil Procedure are observed.

As for the judicial reorganisation proceedings, after nearly 15 years of absence, the matter was addressed by the reform brought by Federal Law No 14.112/2020, which sets forth express rules concerning procedural and substantive consolidation of corporate groups. Despite this, the rules introduced are either redundant or excessively open to interpretation, so the courts remain without a safe basis to apply procedural or substantive consolidation on a case-by-case basis.

Thus, despite the express rules introduced by the reform, the criteria applicable to corporate group insolvencies still have to be extracted from case law. This is not an easy task. First, relevant case law may differ greatly from federal state to federal state, as state courts have exclusive jurisdiction over insolvency matters. Second, the analysed precedents are non-binding,[1] and courts may therefore change their position with little or no regard to previous decisions, which means that judges of the same court may have completely opposing positions. All in all, despite all the efforts, currently there is no reliable and predictable course for all the aspects of joint filings for corporate group restructurings in Brazil.

- **Court-supervised reorganisation of corporate groups**

  The court-supervised reorganisation proceeding is basically a mechanism for forced renegotiation and the restructuring of debt. It was introduced into the Brazilian insolvency system in 2005, with the enactment of the Brazilian Bankruptcy Law.

  The proceeding starts with a petition filed by the debtor, accompanied by the mandatory documents listed in article 51. The court analyses the petition and, if it considers that all the formal requirements have been met, issues an initial order, thus commencing the reorganisation proceeding, staying all enforcement actions

[1] Brazil is a civil law country, in which the *stare decisis* principle has very limited application.

against the debtor and appointing a court trustee to supervise the activities of the debtor company. The debtor then has 60 days[2] to present a reorganisation plan to be voted on by its creditors at the creditors' meeting. During the proceeding, the debtor remains in possession of its business and continues to operate its activities normally. On the other hand, if the necessary majorities for approving the reorganisation plan are not obtained, the court-supervised reorganisation proceeding is converted into a bankruptcy liquidation proceeding.

It is very common for corporate groups to jointly file for a court-supervised reorganisation. Before the comprehensive legal reform in 2020, the debtor companies filed jointly based on the general rules on the matter contained of the Brazilian Code of Civil Procedure.[3] After the recent legal reform, article 69-G was introduced to the Brazilian Bankruptcy Law, allowing companies of the "same corporate group" to jointly file for reorganisation. Each debtor has to meet the legal requirements for filing for court-supervised reorganisation and shall submit the required documentation. The petition shall be filed before the court where the principal place of business of the corporate group is located. If the requirements are met, the court will appoint a single judicial administrator for the group and will order the procedural acts to be coordinated or performed jointly.

In general, even before the legal reform and the introduction of article 69-G, courts have authorised the commencement of joint reorganisation proceedings for corporate groups. Most litigation at this point involves other issues, such as which companies are part of the corporate group, which criteria should be applied to determine whether a company is part of the same corporate group, and the location of the principal place of business of the corporate group. But, in any event, the joint filings have widely been accepted by courts.

A study reproduced in an academic paper published before the reform demonstrates such wide acceptance of joint filings by courts.[4] The study conducted an empirical analysis of 41 court-supervised reorganisations involving multiple debtors, filed between 1 September 2013 and 1 October 2015, before the first and second lower civil courts for bankruptcy proceedings in the City of São Paulo (Bankruptcy Courts for the City of São Paulo).

The study found that, in all such proceedings, even before the legal reform and the inclusion of express provisions in regard to procedural and substantive consolidation, the two Bankruptcy Courts for the City of São Paulo admitted a single proceeding for the debtor companies and appointed one trustee for all companies, based on the above-mentioned civil procedure rule for multiparty lawsuits.

[2] Article 219 of the new Brazilian Code of Civil Procedure, enacted in 2015, determines that only business days shall be counted for all legal time periods. There has been a certain amount of controversy over whether such provision is applicable to the insolvency proceedings regulated by the Brazilian Bankruptcy Law, especially since the inclusion of art 189, § 1°, I to the Brazilian Bankruptcy Law, which states that all time periods related to procedures set forth in the Brazilian Bankruptcy Law should be counted in calendar days. Even before the inclusion of this article, the latter has been the prevalent position of the courts, based on some precedents of the Superior Court of Justice – STJ.

[3] The current Brazilian Code of Civil Procedure was enacted in 2015. The previous code from 1976, however, contained the very same rule in its art 46.

[4] CEREZETTI, Sheila Neder e SATIRO, Francisco. "*A silenciosa 'consolidação' da consolidação substancial*", in Revista do Advogado No 131, October 2016, coord ADAMEK, Marcelo Vieira.

Even though there is no similar study for any other courts, this probably also holds true in other states as a matter of practice. The appellate courts have also endorsed such wide acceptance of joint filings.

Joint filings are thus widely accepted in Brazil, thereby pre-empting any necessity for cooperation and coordination between courts and insolvency practitioners (IPs), or the need for a group coordinator.

However, there are different rules applicable for *substantive* consolidation of debtor companies. Brazilian Courts have adopted different positions over the matter. The recent legal reform included express provisions on the topic, but these provisions are yet to be consistently construed by case law. Consequently, the guidelines for the application of substantive consolidation remain not entirely clear.

- **Bankruptcy liquidation proceedings of corporate groups**

The bankruptcy liquidation proceeding basically consists of a free and clear sale of all the company's assets (preferably in a bundle) in order to pay the creditors pursuant to the priority order provided in article 83 of the Brazilian Bankruptcy Law. It may be initiated either voluntarily by the debtor, or involuntarily by creditors or the court.

Voluntary bankruptcy liquidation proceedings are rare in Brazil. The bankruptcy liquidation proceedings have generally been regarded as value destructive. Moreover, bankruptcy liquidation proceedings have been heavily associated with fraudulent schemes, so courts did not shy from piercing the corporate veil of the debtor company to hold officers, shareholders and other affiliated companies liable for the debts of the bankrupt company. Courts even used to have the power to drag other companies belonging to the same corporate group, as well as officers and shareholders, into the bankruptcy liquidation proceeding (*extensão dos efeitos da falência*). Such possibility was eliminated by the recent legal reform, which prohibits any kind of extension of the effects of the bankruptcy liquidation to other companies not included in the initial request. The legal reform also intends to make bankruptcy proceedings far more effective and expeditious.

As the legal reform is recent and its benefits are still to be confirmed by case law, companies (and corporate groups) almost never voluntarily file for bankruptcy liquidation. It is common that corporate groups litigate aggressively to avoid even a single affiliated company being declared bankrupt and prefer to pre-emptively file for a court-supervised reorganisation, even when there is no going concern. This pre-emptive use of the reorganisation proceeding means that bankruptcy liquidation proceedings are usually commenced only after a reorganisation proceeding is forcibly converted into a bankruptcy liquidation proceeding, as it is clear that the debtor company has no going-concern value and is unable to comply with the reorganisation plan. This has been the case, for example, in the case of large corporate group proceedings in Brazil such as Varig[5] (the largest Brazilian

[5] Dockets no. 0260447-16.2010.8.19.0001, filed on August 13th, 2010, before the 1st Business Court of Rio de Janeiro (Bankruptcy Liquidation). Dockets no. 0071323-87.2005.8.19.0001, filed on June 17th, 2005, before the 1st Business Court of Rio de Janeiro (Judicial Reorganisation).

airline), Vasp[6] and Avianca[7] (each of which are also large airlines) and the Mabe Group[8] (a home appliances manufacturer). In such cases, court-supervised reorganisation proceedings were converted into bankruptcy liquidations, following the failure or inability to comply with the reorganisation plan. Since the court-supervised reorganisation proceeding of such groups was already substantively consolidated, the bankruptcy liquidation proceeding that followed was also consolidated.

More recently, as mentioned, the legal reform introduced significant changes to the bankruptcy liquidation proceeding in order to make it more agile and efficient. As some of the most notable measures, the deadlines for both the sale of the assets of the estate and the application of the bankruptcy discharge were drastically reduced. Whether such measures will actually make the procedure more efficient or stimulate its use in any way is yet to be seen.

- **Expedited pre-packaged reorganisation proceedings**

  An expedited reorganisation basically involves a prior out-of-court negotiation of a pre-packaged reorganisation plan between the debtor and its creditors, who then file for court confirmation of the reorganisation plan. The expedited reorganisation proceeding may only be filed by the debtor (creditors cannot file for an expedited reorganisation of the debtor). By the time of the filing, debtors must submit to the court a pre-packaged plan already endorsed and signed by the adhering creditors for it to be binding on non-adhering creditors.

  Although the recent legal reform aimed at incentivising the use of this mechanism, expedited pre-packaged reorganisation proceedings are still rare in Brazil in comparison with court-supervised reorganisation or bankruptcy liquidation proceedings. Nonetheless, corporate groups that have filed for confirmation of their pre-packaged reorganisation plans have done so jointly. Although there are no specific tests for procedural or substantive consolidation of debtors in expedited reorganisation proceedings, the rules applicable to court-supervised reorganisations shall be applied.

1.1 Corporate group versus individual legal entity

1.1.1 The insolvency and restructuring systems that are in force

As explained above, the recent legal reform introduced express rules on procedural and substantive consolidation of corporate groups. Article 69-G of the Brazilian Bankruptcy Law allows any companies of the "same corporate group" to file for judicial reorganisation jointly. This means that there will be a single procedure, with a single bankruptcy trustee, and with the possibility of a single joint reorganisation plan for all the companies. However, unless the court allows substantive consolidation of the debtors, there will be an individual creditors' meeting for each entity, in which deliberations over debt restructuring and recovery measures will be taken separately. In this scenario, the bankruptcy liquidation of one company will not necessarily entail

[6] Dockets no. 0070715-88.2005.8.26.0100, filed on July 1st, 2005, before the 1st Bankruptcy Court of São Paulo.
[7] Dockets no. 112565881-2018.8.26.0100, filed on December 10th, 2018, before the 1st Bankruptcy Court of São Paulo.
[8] Dockets no. 0005814-34.2013.8.26.0229, filed on May 3rd, 2013, before the 2nd Bankruptcy Court of São Paulo.

the liquidation of the others. As such, the proceeding may be split into as many others as necessary to reflect that some entities may remain under reorganisation while others may be liquidated.

In addition to procedural consolidation, article 69-J of the Brazilian Bankruptcy Law also for the substantive consolidation of corporate groups which file for reorganisation jointly, as long as the following cumulative criteria are met:

(i) debtors shall belong to the same corporate group;

(ii) debtors shall have filed for joint judicial reorganisation under article 69-G;

(iii) there shall be commingling of assets or liabilities between the debtors, which cannot be undone without excessive expenditure of time or resources; and

(iv) at least two of the following conditions must be verified:

   (a) there must be cross-guarantees between debtors;

   (b) there must be a relationship of control or dependency between the debtors;

   (c) there must be partial or total coincidence between the shareholders or quotaholders of the debtors; and

   (d) the debtors must present themselves to the market as a single economic entity.

If the substantive consolidation is imposed by the court under article 69-J, all the assets and liabilities of all the debtors will be pooled together, with the extinction of any intercompany claims and guarantees, and, for the specific purposes of the judicial reorganisation, the debtors will be treated as if they were a single economic entity. All the debtors will be subject to a single joint reorganisation plan, and all quorums and decisions will be made by a single consolidated meeting of creditors which will include all the creditors of all the debtor companies. Any bankruptcy liquidation decree will necessarily be imposed over all the debtors, and the substantive consolidation will tend to remain in place during the bankruptcy liquidation proceeding that will follow.

Although the reform has included express rules on the matter, the absence of which had been felt since the edition of the Brazilian Bankruptcy Law in 2005, the new rules do not entirely eliminate the uncertainties that existed in the previous scenario, as "core" aspects of substantive consolidation remain to be decided by courts on a case-by-case basis. Thus, we do not believe that the new rules represent any significant improvement on the matter of substantive consolidation, which will remain being addressed by case law on similar grounds.

1.1.2 Definition of a corporate group

Chapter XXI (Articles 265 to 276) of Federal Law No 6.404/1976 (Brazilian Corporate Law) adopts the legal concept of a corporate group.

Article 265 of the Brazilian Corporate Law states:

> "The holding company and its subsidiaries may, in accordance with this Chapter, constitute corporate groups through a group convention under which they oblige themselves to combine resources or efforts to realize their corporate purpose, or take part in common projects."

Articles 266 to 276 regulate internal relationships among the companies that comprise such formal corporate groups.

Even though the Brazilian Corporate Law provides such a legal framework for corporate groups, with a detailed applicable regime, very few holding companies execute formal legal group conventions with their controlled subsidiaries in order to become "legal corporate groups". In fact, it is commonplace among commentators and courts that such a legal framework is not used.

Thus, most corporate groups are characterised by a holding company that holds controlling stakes in subsidiaries without entering into formal legal group conventions. Such groups are called "*de facto*" corporate groups as opposed to "legal" corporate groups regulated by the Brazilian Corporate Law.

1.1.3 Legislation relating to corporate groups

The concept of a "corporate group" is also adopted in other pieces of legislation. In this regard, article 2, §2 of the 1942 Brazilian Labor Code establishes that

> "[w]henever one or more companies, each one being a separate legal entity, is under the direction, control or administration of another company, constituting an industrial, commercial or other economic activity group, such company shall be jointly and severally liable for the purposes of labor debts, with the company which is the main debtor."

Also, Brazilian case law, applying article 124 of the Brazilian Tax Code, holds affiliated companies belonging to the same corporate group liable for tax debts.

In competition law, article 88 of Law No 12.529/2012 also establishes that certain concentrations involving "groups" with revenues that exceed certain thresholds should also be analysed by the Brazilian Antitrust Authority.

In environmental law, other companies of the same corporate group are held responsible for environmental damages whenever the violating company is not capable of compensating the damages caused to the environment.

Finally, in insolvency proceedings, a decision by the Superior Court of Justice has ruled that

> "a corporate group […] exists when the various legal entities carry out their activities as if they were, in managerial, labor and assets terms, a single entity, it being legitimate to pierce the corporate veil of the bankrupt company so that the effects of the bankruptcy decree affect other companies."

This definition has been used, for example, by the 1st Bankruptcy Court for the City of São Paulo to verify the existence of the corporate group.

1.2 Corporate group versus individual corporate benefit

1.2.1 The existence and relevance of "corporate group benefits"

Article 245 of the Brazilian Corporate Law states:

> "Officers and directors may not, to the detriment of the company, favor an affiliated, parent or subsidiary company, and must ensure that transactions between affiliated companies, if any, comply with strictly commutative conditions or with adequate consideration; and the officers and directors shall be held personally liable for losses and damages resulting from acts committed in violation of the provisions of this article."

Thus, article 245 of the Brazilian Corporate Law expressly denies any form of "corporate group benefit".

Brazilian law also does not expressly deal with the matter of upstream or downstream guarantees. There is no express permission, prohibition or limit to the personal guarantees that can be provided by subsidiaries or parent companies. However, although such guarantees are possible and theoretically unrestricted, they should be provided under reasonable conditions and with a clear picture of the consideration that will be given to the guarantor, under penalty of the directors / officers being held liable under article 245 of the Brazilian Corporate Law.

1.2.2 Director liability

This is outlined above.

1.2.3 "Early warning systems"

There are no "early warning systems" in place in Brazil between the directors of individual legal entities and the parent entity. In fact, there is no warning system at all in Brazil, nor is there any obligation to file for bankruptcy in the event of insolvency, as explained below.

1.2.4 Pending or draft legislation

There is no pending or draft legislation relating to these issues.

1.3 Universalism versus territorial principle

1.3.1 Application of the modified universalism rules

As part of the legal reform in 2020, Brazil adopted a modified version of the 1997 United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency (Model Law). As such, Chapter VI-A, comprising article 167-A to article 167-Y, was introduced to the Brazilian Bankruptcy Law, to specifically regulate cross-border insolvencies. Although there are a few deviations from the

UNCITRAL text, local courts are allowed to exercise broad discretion to cooperate and communicate directly with foreign authorities.

The new rules provide for a streamlined procedure aimed at recognition of foreign insolvency proceedings. The foreign representative has standing to file for recognition of the proceeding in which it was appointed. Upon filing of the recognition proceeding, the court has discretion to grant any urgent provisional relief it finds appropriate, including a stay of proceedings to protect the assets.

A foreign proceeding will be recognised as main if filed in the country where the debtor has its centre of main interests. The court will recognise the foreign insolvency proceeding as non-main if it was filed in a country where the debtor has an establishment or assets.

The recognition of a foreign main proceeding triggers certain mandatory effects: a stay of enforcement actions and of individual actions of creditors aimed at collecting debt; a suspension of the statute of limitations; and the ineffectiveness of transfers of non-current assets of the debtors. In addition, upon recognition of a foreign insolvency proceeding, either main or non-main, the court has broad discretion to order any relief it finds appropriate to the foreign representative. Any such discretionary relief is subject to modification or termination by the court at the request of the foreign representative or of any interested party, provided that the interests at stake are adequately protected.

According to the new rules, and following the Model Law, the Brazilian court can exercise broad discretion to cooperate in cross-border insolvency cases to the maximum extent possible. As such, courts can engage in direct communication with foreign authorities and foreign representatives, including to request information or assistance, without having to resort to letters rogatory or any other formality. The court may also approve cross-border agreements or protocols which facilitate coordination and administration of multiple insolvency proceedings.

The new provisions also allow coordination of concurrent insolvency proceedings regarding the same debtor. These rules apply whether there is a local and a foreign insolvency proceeding, or multiple foreign insolvencies, regarding the same debtor taking place concurrently. The general principle under these coordination rules is that a main proceeding shall have worldwide reach and universal effects, while non-main proceedings shall be usually restricted to local assets.

As a result, following the enactment of the Model Law, Brazil seems to have fully incorporated the modified universalism approach to cross-border insolvencies.

1.3.2 Bilateral and / or multilateral treaties in force

Brazil is a signatory to the 1928 Convention of Private International Law, a treaty signed in Havana and intended to provide common rules on conflict of laws between American countries. The Bustamante Code, attached to such convention, provides, among other matters, for rules on cross-border insolvencies applicable to the signatory states. The treaty, which was only ratified by 15 Latin American countries, has seldom been applied in Brazil, and many of its rules are considered to be obsolete.

1.3.3 Pending legislation

There is no pending legislation on these matters.

1.4 Competent court and applicable law

The court of the principal place of business of the debtor has jurisdiction to hear its bankruptcy liquidation, reorganisation proceedings and expedited pre-packaged reorganisation proceedings as applicable (pursuant to article 3 of the Brazilian Bankruptcy Law). For this purpose, the case law tends to interpret the "principal place of business" as the place from which the company is managed, directed, or where the decisions are taken, or, depending on the case, the place where the main operational activities of the company take place. Such determination, however, can be controversial in many instances.

The Brazilian Bankruptcy Law has no specific provisions regarding the principal place of business of a corporate group. In general, the courts have applied the same criteria mentioned above in the case of a joint filing of the corporate group members, i.e. the chosen court must determine whether the principal place of business (based on the criterion mentioned above) of the group is located within its jurisdiction so that the court can extend its jurisdiction to the companies from other locations. As a result, courts may end up having jurisdiction over companies headquartered in different locations, as long as the "principal place of business" of the group is located within that court's jurisdiction.

However, as will be further explained below, the fact that there is a joint filing does not necessarily mean that there will be substantive consolidation, and it does not necessarily mean that there will be only one reorganisation plan for all group members.

If a bankruptcy liquidation or a reorganisation proceeding has already been commenced for a subsidiary, the parent company can still file for bankruptcy, but it must be filed with the court where its principal place of business is located. As a result, different courts may have jurisdiction over the proceedings filed by the parent and the subsidiary.

If one or more of the entities is incorporated abroad, and the court understands that the principal place of business of the group is located in the venue where it sits, it may allow the commencement a proceeding regarding the whole group (thereby extending its jurisdiction to any such foreign entity).

1.4.1 Applicable law that falls outside of the **lex fori concursus** *and related issues*

Regarding applicable law, Decree No 4.657/1943 regulates conflict of laws in Brazil. It does not contain any provision on insolvency proceedings, but the situations in which foreign statutes are applicable in Brazil are very limited.

Following the 2020 reform, Brazilian Bankruptcy Law contains a specific chapter on cross-border insolvencies (as described above). In this regard, Brazilian courts would generally apply Brazilian legislation to insolvency proceedings commenced in Brazil (as the *lex fori concursus*).

1.4.2 Harmonisation of substantive restructuring and insolvency laws

There are no known attempts to harmonise substantive restructuring and insolvency laws with those of other countries.

1.4.3 Applicable treaties or case law

There has been at least one case in which a Brazilian court, in Rio de Janeiro, has granted provisional temporary relief in a proceeding aimed at recognition of a foreign insolvency proceeding. Apart from that, there are no further treaties or relevant case law other than what is discussed above.

1.4.4 Upcoming new legislation

There is no proposed new legislation in this area.

2. Substantive consolidated restructuring proceedings versus synthetic group restructurings

Brazil has no rules allowing for synthetic secondary proceedings, nor on providing for compliance under local proceedings, of distribution schemes and priorities provided for in other countries. However, it has become common in Brazil for groups of companies, including foreign entities, to file for a local reorganisation and to be substantively consolidated, resulting in the application of Brazilian rules for all such entities and their creditors.

As a matter of fact, as mentioned above, even before the legal reform introduced formal statutory provisions regarding substantive consolidation, substantive consolidated corporate group reorganisation proceedings were possible in Brazil, and many of the biggest court-supervised reorganisation proceedings in Brazil involved corporate groups in substantive consolidation.

For example, the Oi Group[9] case was one of the biggest court-supervised reorganisation proceedings in Brazil so far, in which seven companies of the same corporate group, including two foreign entities, aimed to restructure a consolidated debt of around USD $20 billion. The case was filed in June 2016, and a formal court decision authorising the substantive consolidation between the debtors was issued on 21 August 2017.

Another example is the PDG Group[10] case, a court-supervised reorganisation that involved 512 debtor companies with a reported indebtedness of BRL $6.2 billion. The case was filed on 23 February 2017, and the joint reorganisation plan, presented by the debtors, all substantively consolidated, was approved by the creditors in a deliberation in which they were all pooled together, and confirmed by the Bankruptcy Court in December 2017.

There are many other examples of consolidated corporate group proceedings, either in court-supervised reorganisation proceedings or expedited pre-packaged reorganisation proceedings.

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[9] Dockets no. 0203711-65.2016.8.19.0001, filed on June 20th, 2016, before the 7th Business Court of Rio de Janeiro.

[10] Dockets no. 1016422-34.2017.8.26.0100, filed on February 23rd, 2017, before the 1st Bankruptcy Court of São Paulo.

However, it is important to stress that, prior to the legal reform, the Brazilian Courts had not adopted a uniform stance on the matter of substantive consolidation, and the criteria for its application varied greatly from case to case. As noted above, the express provisions regarding substantive consolidation introduced by the recent legal reform may not contribute to a uniform approach on the matter.

For example, the 1st and the 2nd Bankruptcy Courts of São Paulo have often diverged on the matter, and the precedents of the Court of Appeals of the State of São Paulo have also gone in different directions. Previously, up until 2015, neither the Bankruptcy Courts of São Paulo nor the Court of Appeals of the State of São Paulo applied different tests to allow joint filing and substantive consolidation.

So, for instance, the academic research paper noted above[11] has concluded that, for the analysed court-supervised reorganisation proceedings in the study, a joint filing automatically entailed substantive consolidation, even if there was no decision authorising the consolidation of assets and liabilities of the debtor companies. Once the Bankruptcy Courts of São Paulo had admitted a joint filing for a corporate group, a substantive consolidation would follow automatically, and the corporate group would simply present a single consolidated reorganisation plan, and creditors would vote on it as if they were all creditors of a single entity. And, even when such "silent" substantive consolidation was challenged, the Court of Appeals of the State of São Paulo would treat a "joint filing" and a "substantive consolidation" similarly.

From 2015 onwards, both the Bankruptcy Courts and the Court of Appeals of the State of São Paulo started to tackle the issue of substantive consolidation in their decisions.

The 2nd Bankruptcy Court of São Paulo has expressly considered substantive consolidation whenever issuing a commencement order. In such decisions, the court expressly stated that a joint filing does not necessarily entail substantive consolidation, and that the appointed court trustee should first analyse the extent to which the assets and liabilities of the debtors are commingled and render an opinion on whether a substantive consolidation of the group would be appropriate. Such a proceeding has been adopted, for example, in the Viver Group[12] and Bmart Group[13] court-supervised reorganisation proceedings.

In the Viver Group case, the court trustee (KPMG) issued an expert opinion concluding that a partial substantive consolidation would be more appropriate, meaning that 40 debtor companies could present a single consolidated reorganisation plan, but 16 other debtors that were special purpose entities (SPEs) would have to present separate plans. In the Bmart Group, the court trustee considered that the assets and liabilities were so commingled across the entities within the corporate group that a substantive consolidation was inescapable.

The 1st Bankruptcy Court of São Paulo has taken a different stance, usually authorising joint filings and substantive consolidation without requiring a previous opinion by the court trustee. An example is the case of PDG Group, which filed for reorganisation on 23 February 2017. PDG is a publicly held company, and its court-supervised

[11] See above, n 4.
[12] Dockets no. 1103236-83.2016.8.26.0100, filed on September 16th, 2016, before the 2nd Bankruptcy Court of São Paulo.
[13] Dockets no. 1012521-92.2016.8.26.0100, filed on February 11th, 2016, before the 2nd Bankruptcy Court of São Paulo.

reorganisation involves 512 debtor companies and reported indebtedness of BRL $6.2 billion. In the commencement order, dated 2 March 2017, the judge authorised the joint filing and appointed PriceWaterhouseCoopers as court trustee but did not order it to issue an opinion on the substantive consolidation of the PDG Group.

Furthermore, the Bankruptcy Appellate Panels for the State of São Paulo have issued opinions tackling the issue of substantive consolidation. In this regard, the OAS Group[14] was a case in which substantive consolidation was litigated very aggressively.[15] In this case, the 2nd Panel for Business Matters of the Court of Appeals of São Paulo issued a split opinion, authorising the substantive consolidation. In another case, however, the same 2nd Panel has recently ruled that substantive consolidation was inadmissible for the Alcometalic Group[16] and ordered each debtor company to present its own individual reorganisation plan.

In addition, there has been a trend among Brazilian Courts in some cases to modulate the effects of substantive consolidation, or to delegate such decision to the creditors. This results in cases in which, although the procedural consolidation is fully in place, substantive consolidation among the debtor companies applies only in part.

This has been the case, for example, for the Renova Group[17] (a renewable energy corporate group) reorganisation proceeding, in which the 2nd Bankruptcy Court of São Paulo accepted the joint filing (procedural consolidation) for all companies of the group, but at the same time ruled that the substantive consolidation should be applied in two different blocks of companies, thus creating two different groups of

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[14] Dockets no. 1030812-77.2015.8.26.0100, filed on March 31st, 2015, before the 1st Bankruptcy Court of São Paulo.

[15] The OAS Group was one of the largest construction conglomerates in Brazil, but it faced a severe financial downturn after its involvement in Brazil´s largest corruption scandal. The group filed a joint reorganisation proceeding on 31 March 2015, which involved 10 companies from the group, including two foreign subsidiaries. On 1 April 2015, the 1st Bankruptcy Court for the City of São Paulo authorised the commencement of a consolidated proceeding of the OAS Group and appointed Alvarez & Marsal as judicial administrator for all the companies. The initial order is only four pages long, but only one single paragraph deals with the joint filing: "the multiparty lawsuit is well justified, in so far as all companies act systemically and integrate the same corporate group. Consequently, the preservation of the social and economic benefits arising from the healthy business activity (which is the object of the present proceeding) will be better furthered if the economic crisis is dealt with in a global manner, considering all the companies that integrate the economic group, and not separately."
On the same date as the commencement order (1 April 2015), the Noteholders of the OAS Group (headed by Aurelius) and Bondholders filed separate motions, requesting that the reorganisation proceedings be split and that different reorganisation plans be presented by each debtor company of the OAS Group. On 6 April 2015, the judge denied such motions, and stated that the "global solution" was more appropriate for the OAS Case. After this, on 4 May 2015, the Noteholders and Bondholders appealed to the 2nd Bankruptcy Appellate Panel for São Paulo state and later, on 15 May 2015, HSBC and Deutsche Bank also filed appeals against the initial order. The four appeals requested the separation of the court-supervised reorganisation proceeding and that each debtor company present a separate reorganisation plan. The public attorney sided with the creditors and issued an opinion on 25 June 2015, reasoning that it was in fact inadmissible that assets of companies in very different financial conditions should be consolidated, and that a substantive consolidation should not be effected. On 5 October 2015, after much apprehension, the 2nd Bankruptcy Panel rejected the appeals in a split decision, ruling that the substantive consolidation was permissible for the OAS Group. The appeals were heard by a panel of three judges, two of whom (Carlos Garbi and Carlos Marcelo Mendes de Oliveira) voted in favour of consolidation, and one (Fabio Tabosa) against it.

[16] Dockets no. 1044764-26.2015.8.26.0100, filed on May 11th, 2015, before the 2nd Bankruptcy Court of São Paulo.

[17] Dockets no. 1103257-54.2019.8.26.0100, filed on October 19th, 2019, before the 2nd Bankruptcy Court of São Paulo.

consolidated debtors, with two different creditors' meetings and a different reorganisation plan for each group of consolidated companies – all in the same consolidated proceeding.

On that note, we can also highlight the Odebrecht Group[18] reorganisation proceeding, in which 21 debtor companies jointly filed for judicial reorganisation, but the Court of Appeals of the State of São Paulo ruled that, even if the procedural consolidation was valid, the decision concerning substantive consolidation should be taken by each individual creditors' meeting of each of the debtors. As a result, some of the companies were substantively consolidated and had a single reorganisation plan approved, while others (where the creditors voted against substantive consolidation) had their own individual reorganisation plans.

3. Duty to initiate insolvency process

The only provision in the Brazilian Bankruptcy Law that may be interpreted as establishing an obligation for officers / directors to file for bankruptcy is article 105 of the Brazilian Bankruptcy Law, which reads:

> "The debtor in an economic-financial crisis that considers that he does not meet the requirements to file for a court-supervised reorganisation, must file for bankruptcy, explaining the reasons for the impossibility of continuing business activity."

However, while the duty is established under article 105, there is no specific timeline regarding when such voluntary bankruptcy liquidation should be filed. There is also no specific consequence, either to the debtor company or to its officers / directors, if this voluntary bankruptcy liquidation is not filed.

Within this context, under the Brazilian Corporate Law, it is incumbent upon the general shareholders' meeting to allow the officers / directors to file for bankruptcy or a court-supervised reorganisation. Only in urgent cases, and with the express approval of the controlling shareholder, can the officers / directors file for bankruptcy or a court-supervised reorganisation with the subsequent and immediate call notice to a general shareholders' meeting to deliberate on the matter.

Other than that, officers / directors do have fiduciary duties provided for in the Brazilian Corporate Law and could be held liable if they fail to act in the best interests of the individual legal entity.

The existence of a guarantee from an IP in another country would not impact on the duty under article 105 or the fiduciary duties.

4. Legal certainty and predictability

There is no requirement regarding publicity and the lines of communications that must be installed with the local courts or the local creditors, nor is an IP required to provide any guarantee pending the restructuring or bankruptcy liquidation procedure.

[18] Dockets no. 1057756-77.2019.8.26.0100, filed on June 17th, 2019, before the 1st Bankruptcy Court of São Paulo.

5. Consolidation of assets

5.1 Procedure with respect to the sale of the whole or part of a business

The sale of the whole or part of a business, outside bankruptcy, must follow the procedure / requirements established in the Brazilian Civil Code. Under article 1.144, any contract that involves the sale of part of a business (*estabelecimento*) will only produce its effects with respect to third parties (*erga omnes*) after being registered in the Commercial Registry.

Moreover, pursuant to article 1.145, if the sale has rendered the seller insolvent, then the validity of the sale will depend upon payment, in full, of all creditors of the seller, while such creditors must consent to the sale within 30 days. The buyer also remains liable for all debts that have been duly recorded in the acquired business (article 1.146). The Brazilian Civil Code does not contemplate special quorums or voting requirements for creditors for the sale of all or part of a business outside insolvency, and the consent must be unanimous.

In a restructuring proceeding, the debtor company may sell fungible assets without the need for prior authorisation. However, the sale of non-fungible assets must be preceded by a court authorisation, having heard the creditors' committee (if existing), pursuant to article 66 of the Brazilian Bankruptcy Law. Opposing creditors holding more than 15% of the total claims may convene a creditors' meeting to deliberate on the sale, after posting a bond to guarantee the full price offered.

Also, the sale of all or part of a business, within a restructuring proceeding, may be made free and clear of any liens and liabilities.

In this regard, under article 60 of the Brazilian Bankruptcy Law, the debtor company may sell part of its business, free and clear of all past liabilities, if the sale is: (i) expressly authorised in the reorganisation plan or by the court; and (ii) conducted in compliance with any means provided by article 142 of the Brazilian Bankruptcy Law (including a judicial auction, a competitive process, or a direct sale).

Thus, in a court-supervised reorganisation proceeding, creditors have voting rights on the reorganisation plan, which may include the sale of part of the business of the debtor. In voting on the plan, creditors are divided into four classes: (i) labour-related claims; (ii) secured claims; (iii) unsecured claims; and (iv) claims held by small-sized companies. Creditors whose claims are not affected by the reorganisation plan do not have the right to vote.

The reorganisation plan is approved in one of the following two ways:

- regular creditor majorities: creditors in each class vote to approve the plan. In classes (ii) and (iii) above (i.e. secured and unsecured creditors) the plan must be cumulatively approved: (a) by more than 50% of the creditors, in number, present at the creditors' meeting; and (b) by creditors whose claims represent more than 50% of the total amount of claims of creditors present at the creditors' meeting. In classes (i) and (iv), the plan must be approved by more than 50% of the creditors, in number, present at the creditors' meeting (regardless of the amount of claims held by such creditors); or

- "cram down": the judge may also approve the restructuring plan should the following cumulative requisites be present: (a) creditors holding more than 50% of the claims present at the creditors' meeting (regardless of the class of claims they belong to) vote to approve the plan; (b) the plan is rejected by no more than one class of claims; (c) at least one-third of the creditors in the dissenting class vote to approve the plan; and (d) the plan does not entail unfair discrimination among the creditors belonging to the dissenting class.

Majorities are calculated based on the creditors that effectively attended the creditors' meeting to vote on the plan. Creditors not attending the meeting, and unimpaired creditors as mentioned above, are not considered for the purpose of approval of the plan.

Creditors holding a security interest over the asset must expressly authorise the sale.

In a liquidation proceeding, the sale of all assets of the bankrupt estate is conducted by the trustee appointed by the court following a competitive bid process. Neither shareholders nor creditors have a say in the sale of bankrupt estate assets.

There is a provision in article 145 of the Brazilian Bankruptcy Law which provides that the court may authorise an alternative sale process if previously approved by two-thirds of creditors present at the creditors' meeting.

5.2 Difference in treatment with respect to tangible and intangible assets

Differences in the context of a restructuring proceeding are set out above.

5.3 Role of creditors and creditors' committees in a substantive consolidation

Under Brazilian case law, creditors of the entities being consolidated in an insolvency proceeding do not have to approve substantive consolidation. Rather, as noted above, it is ordered by the court, provided that the legal requirements are met.

However, even though the Brazilian Bankruptcy Law does not contain such an express provision, it is not prohibited that, even in cases that do not meet the legal criteria for substantive consolidation to be imposed by the court, the debtors may propose the substantive consolidation, which will have to be voted on by each general meeting of creditors. As long as the substantive consolidation is approved in the individual creditors' meeting of each company to be consolidated, the substantive consolidation will be applied.

5.4 Voting for or against a substantive consolidation

These matters are addressed above.

6. Equitable distribution and accountability of IPs

In the case of a sale outside a bankruptcy context, if the proceeds of the restructuring or liquidation are insufficient to pay off creditors, the sale may be considered invalid, unless creditors had consented to the sale within 30 days (article 1.145 of the Brazilian Civil Code).

In the case of an extrajudicial winding up of a company, regulated by articles 1.102 to 1.112 of the Brazilian Civil Code (*Liquidação Extrajudicial*), the shareholders, as well as the administrators of a company, would be held jointly and severally liable if the wound up company does not have a regular situation before the tax, labour and social security authorities (i.e. the proceeds of the restructuring or liquidation are insufficient to pay such debts).

In a court-supervised restructuring scenario, the restructuring plan must provide for the *pari passu* payment of creditors in each class of claims subject to the proceeding, according to the provisions approved by the required majorities of creditors. In some circumstances, courts will allow strategic suppliers to receive favourable treatment, provided that such treatment is reasonable and compatible with the commitment of future supply. In this regard, the creditors' meeting may, for example, approve a payment with a haircut or an extension of the debt maturities. If the debtor company fails to comply with the provisions of the restructuring plan, the court-supervised proceeding is converted into a liquidation proceeding.

Finally, in a liquidation scenario, the debtor is discharged upon the full payment of all creditors, the payment of more than 25% of the unsecured claims following realisation of all assets, the termination of the proceeding, or the lapse of three years following the bankruptcy decree, whichever occurs first.

7. Intercompany claims

7.1 Order of priority

Intercompany claims are subordinated claims in a bankruptcy liquidation and have no voting rights in a court-supervised reorganisation proceeding.

It is also worth noting that all claims held by the shareholders (and other members of the corporate group), by officers and by directors are classified as subordinated claims under a bankruptcy liquidation proceeding. Subordinated claims are the most junior claims under a bankruptcy liquidation and are only paid after all other pre-filing unsecured claims have been paid in full; these claims only take precedence over any sums to be returned to the shareholders.

In addition, related parties (such as the members of a corporate group) are not entitled to vote at creditors' meetings.

However, following the legal reform, claims held by shareholders and related companies are considered unsecured (instead of subordinated) if they derive from an arms' length transaction and were contracted under strictly market conditions.

7.2 Concepts that can alter priority

The concepts of "recharacterisation" of intercompany debt as equity or "equitable subordination" are not contemplated under Brazilian Law or case law. However, it should be noted that intercompany debt (that does not derive from arms' length transactions) is subordinated to all other claims in a bankruptcy liquidation proceeding (and senior only to equity).

8. Administering a complex estate in one single consolidated procedure

More than one group can exist within an enterprise group for insolvency purposes, even though there is no statutory provision for such or any settled case law. So, for example, in the Renuka[19] case, an enterprise group was divided into two subgroups for purposes of voting on the reorganisation plan. In this case, the 2nd Bankruptcy Appellate Panel mandated separate voting for the two "groups" that constituted the Renuka Group, reasoning that the Renuka Group was formed in 2010, when an Indian company (Shree Renuka) acquired two independent corporate groups which were active in the sugar and ethanol business and which had maintained some form of autonomy.

However, even though each "group" within the Renuka Group presented separate reorganisation plans and two different creditors' meetings were held for each group, there was a single proceeding for the whole enterprise group before a single judge, and with one court trustee for the enterprise group.

9. Handling an insolvent parent with a healthy subsidiary

It would be possible for solvent subsidiaries to be consolidated within an insolvent group. One of the reasons for this is that, under Brazilian Law, there is no insolvency test for a reorganisation proceeding – the only legal requirement being that the corporate group is undergoing a financial or economic crisis (regardless of actual solvency). Courts usually accept claims of financial or economic distress made by debtors without applying any specific test. Consequently, corporate groups may file jointly and include solvent subsidiaries in their petition.

Although there is no legal provision on this, creditors, on the other hand, have challenged the inclusion of solvent subsidiaries in court-supervised reorganisation filings. So, for example, in the OAS Group case referred to above, the bondholders appealed against the initial order, requesting that the subsidiary that had issued the bonds (SPE Gestão e Exploração de Arenas Multiuso SA) be excluded from the reorganisation, since they were the only creditors and there were enough assets to the pay the bonds. However, the 2nd Bankruptcy Appellate Panel rejected this argument, and considered that a "global solution" was more suitable.

[19] Dockets no. 1099671-48.2015.8.26.0100, filed on September 29th, 2015, before the 1st Bankruptcy Court of São Paulo.

CANADA

1. Consolidated group restructurings versus cooperation or coordination procedure

Canadian restructuring and insolvency proceedings are governed by two federal statutes, the Bankruptcy and Insolvency Act (BIA) and the Companies' Creditors Arrangement Act (CCAA). These statutes contemplate liquidation and reorganisation proceedings on both a personal and corporate level.

The BIA addresses straight liquidation proceedings, secured creditor enforcement through the appointment of a receiver, as well as debtor in possession restructuring "proposals" designed to enable an insolvent business to stay alive by reaching an agreement with the debtor's creditors.

The CCAA is largely used to effect commercial restructurings referred to as "plans of arrangement or compromise", designed to enable a corporation to avoid bankruptcy and to restructure as a going concern (each a Plan). The CCAA, however, is also commonly used to facilitate the sale of the assets of a business. The CCAA applies only to corporations with debt in excess of CAD $5 million. The CCAA requires the court to appoint a monitor (an officer of the court) to oversee the debtor company during the restructuring process and to provide regular reports to the court. The vast majority of relief sought and granted under the CCAA is subject to the court's discretion.

1.1 Corporate group versus individual legal entity

Insolvency proceedings of corporate group members are frequently consolidated on a *procedural* basis in Canadian restructuring and insolvency proceedings.

Under the BIA, a debtor may seek an order of the court procedurally consolidating proceedings between related entities. Under the CCAA, only one court application is required for corporate groups. All related corporate entities may be listed as "applicants", to the extent they otherwise qualify under the CCAA, thereby procedurally consolidating from the outset. Alternatively, a motion may be brought before the court seeking to add or remove parties from the application.

A stay of proceedings is generally extended to all applicant entities. Under the CCAA, the court has the discretion to make an order staying proceedings, restraining further proceedings and prohibiting the commencement of proceedings provided the court is satisfied that the appropriate circumstances exist.[1] The court also has the ability to impose a stay of proceedings to non-applicant parties who could potentially jeopardise the effective reorganisation of the applicants.[2] Canadian courts have extended the stay of proceedings beyond the applicant corporate group to facilitate restructuring and to maintain stability and value for the benefit of the applicants' stakeholders.[3]

The restructuring of corporate groups has given rise in certain circumstances to substantive (as opposed to procedural) consolidation of estates. This doctrine simplifies a corporate group by treating the separate entities as if they were a single surviving legal entity. Similar to many other jurisdictions, there are not many reported cases where substantive consolidation is granted over the objections of creditors in Canada.

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1 CCAA, s 11.02.

2 *Re Cinram International Inc*, 2012 ONSC 3767.

3 *Re Lehndorff General Partner Ltd,* [1993] OJ No 14, 17 CBR (3d) (Ont Sup Ct J); see also *Imperial Tobacco Canada Limited, et al, Re,* 2019 ONSC 1684.

The test for substantive consolidation was discussed in *Re Nortel Networks Corp*[4] (*Nortel*).

In the context of determining an allocation of proceeds of sale of various assets, the Ontario Superior Court of Justice (Commercial List) (Ontario Court) considered the availability of substantive consolidation and held as follows:

> "The propriety of ordering substantive consolidation is determined by a balancing of interests. The relevant enquiry asks whether "the creditors will suffer greater prejudice in the absence of consolidation than the debtors (and any objecting creditors) will suffer from its imposition".[5]

The Ontario Court listed seven factors which developed from Canadian jurisprudence to assist in the balancing of interests. Those factors are:

- difficulty in segregating assets;
- presence of consolidated financial statements;
- profitability of consolidation at a single location;
- co-mingling of assets and business functions;
- unity of interests in ownership;
- existence of intercorporate loan guarantees; and
- transfer of assets without observance of corporate formalities.[6]

The Ontario Court has also considered the conditions under which the estates of separate corporate entities can be substantially consolidated. In *Re Redstone Investment Corporation,*[7] the Ontario Court considered the law surrounding substantive consolidation in Canada and the United States and noted that in addition to showing that the "elements of consolidation" are present (the seven factors enumerated above), it must also be shown that the consolidation would effect a general benefit or, alternatively, prevent harm or prejudice.

Procedurally, the costs of consolidated restructuring proceedings can be allocated across various estates on a case-by-case basis.

1.1.1 The insolvency and restructuring systems that are in force

Both the BIA and CCAA apply to the individual entity engaged in the proceedings. However, as described above, it is possible and common to procedurally consolidate proceedings to bring all relevant related entities into one proceeding.

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[4] *Re Nortel Networks Corp,* 2015 ONSC 2987, leave to appeal to OCA denied, leave to appeal to SCC discontinued.
[5] *Idem*, [220].
[6] *Idem*, [221].
[7] *Re Redstone Investment Corp (Receiver of),* 2016 ONSC 4453, [47].

1.1.2 Definition of a corporate group

There is no specific definition in Canadian corporate, insolvency or restructuring legislation of a "corporate group". However, case law dictates that the goals of the CCAA apply not only to individual companies but to interdependent corporate groups operating as a single enterprise, particularly when the treatment of the corporate group as an integrated system will result in greater value to creditors. The court may therefore consider the implications of the corporate group's reorganisation efforts as a whole.[8]

The BIA defines "related persons", in the corporate sense, as two entities:

- both controlled by the same person or group of persons;
- each of which is controlled by one person and the person who controls one of the entities is related to the person who controls the other entity;
- one of which is controlled by one person and that person is related to each member of a related group that controls the other entity;
- one of which is controlled by one person and that person is related to each member of an unrelated group that controls the other entity;
- one of which is controlled by a related group a member of which is related to each member of an unrelated group that controls the other entity; or
- one of which is controlled by an unrelated group each member of which is related to at least one member of an unrelated group that controls the other entity.[9]

Although Canadian restructuring and insolvency law has a related parties definition as outlined above, the practical application of the related party concept is restricted to assessing reviewable transactions and certain voting restrictions.[10] For example, a related party is not able to vote in favour of a proposal or plan put to creditors; the related party may only vote against but not for the acceptance of the proposal or plan.[11]

The concept of a corporate group exists in other legislation which may have application incidentally in Canadian restructuring and insolvency proceedings. For example, certain environmental legislation imposes liability on individuals with effective control of an entity, whether or not the individual is a director or officer of the entity that is the subject of the proceedings, or that of a corporate group.

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[8] *Re Smurfit-Stone Container Canada Inc* (2009), 181 ACWS (3d), 61 CBR (5th) 92 (Ont Sup Ct J).
[9] BIA, s 4(2)(c).
[10] The BIA uses the concept of "related persons" in this context: persons are related to each other and are "related persons" if they are: (a) individuals connected by blood relationship, marriage, common-law partnership or adoption; or (b) an entity and (i) a person who controls the entity, if it is controlled by one person; (ii) a person who is a member of a related group that controls the entity; or (iii) any person connected in the manner set out in paragraph (a) to a person described in subparagraph (i) or (ii): see BIA, ss 4(2)(a), 4(2)(b).
[11] *Idem*, s 54(3).

As a further example, certain Canadian statutes which address labour and employment laws (generally regulated on a provincial level) encompass the concept of a "related employer"[12] when creating protections for the employees of insolvent entities under the same common control or direction as certain related entities.

1.1.3 *Legislation relating to corporate groups*

There are currently no public company or insolvency draft laws providing for a corporate group concept. It is customary that Canadian laws are reviewed every five years.[13] The Superintendent of Bankruptcy, the administrative centre responsible for the integrity of Canada's bankruptcy system, has sought public feedback on issues or concerns with Canada's insolvency system, but at the time of publishing nothing has been formally proposed or made public.

1.2 Corporate group versus individual corporate benefit

1.2.1 *The existence and relevance of "corporate group benefits"*

The Canada Business Corporations Act, RSC 1985, c C-44 (CBCA) and most provincial corporations statutes do not prohibit corporations incorporated thereunder from providing financial assistance to related individuals or entities. However, some provincial corporations statutes require that a corporation that provides financial assistance to certain related parties disclose this assistance to its shareholders.[14]

Some provincial corporations statutes also require that the "assisting corporation", whether a parent, affiliate or subsidiary of the corporation that is being assisted, pass a solvency test before providing financial assistance to a related party. In general, the solvency test has two components: (i) does the assisting corporation have sufficient liquidity to meet ongoing expenses (including to service its debt); and (ii) does the total realisable value of all of the assisting corporation's assets exceed the sum of its liabilities and stated capital.[15]

1.2.2 *Director liability*

Although there is no prohibition on corporations providing financial assistance to related corporations, the assisting corporation, as well as its directors and officers, may be subject to an oppression remedy claim by the assisting corporation's shareholders or creditors, if by guaranteeing a related entity's debt they have acted in an oppressive manner.

Generally speaking, directors and officers owe a fiduciary duty to the corporation of which they are a director and officer and not to a corporate group as a whole.[16]

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[12] See, for example, the Labour Relations Act 1995, SO 1995, c 1, which gives the Ontario Labour Relations Board discretion to make a related employer declaration when three conditions are present: (i) there is more than one entity involved; (ii) related or associated activities or businesses are carried on by the entities concerned; and (iii) the activities or businesses are under common control or direction.

[13] BIA, s 285; CCAA, s 63.

[14] See, for example, Business Corporations Act (Alberta), RSA 2000, c B-9, s 45; Business Corporations Act (British Columbia), SBC 2002, c 57, s 195; The Business Corporations Act (Saskatchewan), RSS 1978, c B-10, s 42.

[15] See, for example, Companies Act (PEI), RSPEI 1988, c C-14, s 69; Corporations Act, RSNL 1990, c C-36, s 78.

[16] *Re BCE Inc*, 2008 SCC 69.

In circumstances where all of the directors have resigned, or have been removed by the shareholders without replacement, certain Canadian jurisdictions deem that any person who manages or supervises the management of the corporation is a director of the corporation.[17]

Under the federal and provincial corporations statutes, certain individuals and entities may have an oppression remedy against the directors and officers of a debtor corporation. Section 241 of the CBCA provides that a creditor may bring an action against a debtor if: (i) any act or omission of the debtor or any of its affiliates causes a result; (ii) the business or affairs of a debtor or any of its affiliates are or have been carried on or conducted in a manner; or (iii) the powers of the directors of a debtor or any of its affiliates are or have been exercised in a way, that is oppressive or unfairly prejudicial to or unfairly disregards the interests of a creditor. Courts have interpreted this section to apply both to a debtor corporation and its directors and officers.[18]

1.2.3 *"Early warning systems"*

There is no requirement that early warning systems be in place as between directors of individual entities in a corporate group and the corporate parent. However, in certain circumstances, the directors of the individual entities may be liable by statute or common law for certain of the entities' unpaid obligations in the event of an insolvency. For example, directors may be liable for unpaid wages,[19] deducted but unremitted source deductions,[20] and certain sales taxes.[21]

1.2.4 *Pending or draft legislation*

There is no draft legislation dealing with this issue under consideration.

1.3 Universalism versus territorial principle

1.3.1 *Application of the modified universalism rules*

Canada would not specifically apply the modified universalism rules as recognised in the EIR Recast (Regulation (EU) 2015/848). However, the extremely flexible nature of the CCAA (as described further below) would make it possible, in the appropriate circumstances, to apply the necessary principles.

1.3.2 *Bilateral and / or multilateral treaties in force*

Canadian based cross-border restructurings and insolvencies are not governed by treaties, but by a modified version of the United Nations Commission on International Trade Law Model Law on Cross-Border Insolvency incorporated into both the CCAA and BIA. The common law principles of comity also apply.

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[17] See Business Corporations Act (Ontario), RSO 1990, c B 16, s 115(4); and CBCA, s 109(4).
[18] *Budd v Gentra Inc*, [1998] OJ No 3109, 111 OAC 288 (Ont CA).
[19] See Business Corporations Act (Ontario), RSO 1990, c B 16, s 131; CBCA, RSC 1985, c C-44, s 119; Business Corporations Act (Alberta), RSA 2000, c B-9, s 119; and Business Corporations Act (Saskatchewan), c B-10, s 114.
[20] Income Tax Act, RSC 1985, c 1 (5th Supp), s 227.1.
[21] Excise Tax Act, RSC 1985, c E-15, s 323.

1.3.3 Pending legislation

There is no pending legislation on this issue at present.

1.4 Competent court and applicable law

Restructuring proceedings under the CCAA may be commenced in any province in which a debtor of a corporate group has its head office or chief place of business or, if the debtor does not have a place of business in Canada, in any province where it has assets.[22]

Under the BIA, an insolvency proceeding may be commenced in any province where the debtor has carried on business or resided in the year immediately preceding the date of the bankruptcy, or where most of the debtor's property is located.[23]

A restructuring proceeding must be commenced in the provincial superior courts.

A need to have the centre of main interests (COMI) determined only arises in cross-border restructurings; it does not arise in domestic proceedings. The COMI determination is made by the receiving court, that is the court that is asked to recognise a foreign proceeding as a foreign main (or non-main) proceeding.

In Canada, COMI is determined on an entity-by-entity basis in corporate group restructurings. Section 45(2) of the CCAA and section 268(2) of the BIA contain a presumption that, absent proof to the contrary, a debtor's registered office is its COMI. However, when it is necessary to go beyond this presumption, case law has indicated that a court will begin its consideration of COMI with the following three factors: (i) whether the location is readily ascertainable by the company's creditors; (ii) whether the location is one in which the debtor's principal assets or operations are found; and (iii) whether the location is where management of the debtor takes place.[24]

1.4.1 Applicable law that falls outside of the lex fori concursus and related issues

If a debtor is declared bankrupt by a Canadian court, Canadian law governs the administration and distribution of the bankrupt's estate, including priority determinations.[25] However, for substantive legal determinations, including whether there is a recognisable claim against a debtor, the law of the jurisdiction where the claim arose applies.[26]

1.4.2 Harmonisation of substantive restructuring and insolvency laws

Each country has an interest in creating and ratifying restructuring and insolvency laws based on its own public policy considerations. Harmonising substantive restructuring and insolvency laws across borders would, to an extent, ignore this interest and state sovereignty.

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[22] CCAA, s 9(1). The existence of a bank account in Canada with nominal funds is sufficient to provide jurisdiction to a Canadian court. See *Re Canwest Global Communications Corp*, [2009] OJ No 4286, 181 ACWS (3d) at [30] (Ont Sup Ct J); *Re Cinram International Inc*, 2012 ONSC 3767, [47]; *Re Global Light Telecommunications Inc*, 2004 BCSC 745, [16]-[18].

[23] See definition of "locality of a debtor" at BIA, s 2.

[24] *Re Lightsquared LP*, 2012 ONSC 2994, [25]; *Re MtGox Co*, 2014 ONSC 5811, [21].

[25] Canadian Encyclopedic Digest (4th) vol 10, title 30, § 359; *Canada Deposit Insurance Corp v Canadian Commercial Bank*, [1992] AJ No 1076, [17] (Alta Ct QB), aff'd [1993] AJ No 660 (Alta CA).

[26] *"Strandhill" (The) v Walter W Hodder Co*, [1926] SCR 680, [14].

Further, Canadian courts, where appropriate, will recognise and apply principles of comity to foreign judgments including the recognition of cross-border proceedings under the BIA and CCAA.[27]

Canada has also adopted a modified form of the Model Law which is incorporated in Part XIII of the BIA and Part IV of the CCAA.

1.4.3 Applicable treaties and case law

These issues are outlined above.

1.4.4 Upcoming new legislation

Both the BIA and CCAA require the Minister of Industry to table a report to Parliament on the provisions and operation of the Acts every five years.[28]

The most recent broad amendments to the BIA and CCAA came into force on 1 November 2019.[29] They only apply in respect of proceedings commenced under the BIA or CCAA on or after 1 November 2019, and primarily address the following:

- initial orders granted under the CCAA are restricted to "ordinary course" relief and stays granted under initial orders are limited to 10 days;

- a statutory duty to act in good faith imposed on interested parties in an insolvency proceeding now exists (this was previously limited to a common law duty among counterparties to a contract);

- interested persons are required to disclose any economic interest in the debtor;

- broader "lookback" periods for directors' and officers' liability insurance are extended with respect to reviewable transactions; and

- intellectual property licensees have certain rights now set out by statute in the event of a licensor becoming insolvent.

2. Substantive consolidated restructuring proceedings versus synthetic group restructurings

A hallmark of the CCAA is its flexibility. While synthetic consolidated group restructurings are not expressly contemplated by the CCAA, the flexibility of the Canadian system means that, under the CCAA, the debtor company can structure the proceeding to include all affected corporate groups.

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[27] To recognise a foreign judgment, Canadian courts must be satisfied that the foreign judgment was not obtained by fraud and does not violate principles of natural justice or Canadian public policy. *Beals v Saldanha*, 2003 SCC 72, [40]. According to the Supreme Court of Canada, a foreign judgment will not be enforced if it is "founded on law contrary to the fundamental morality of the Canadian legal system" or if the judgment was rendered by a foreign court that is "proven to be corrupt or biased" (*idem*, [72]).

[28] BIA, s 285; CCAA, s 63.

[29] Bill C-86, A second Act to implement certain provisions of the budget tabled in Parliament on February 27, 2018 and other measures, 1st Sess, 42nd Parl, 2015 (assented to December 13, 2018), 2018 c 27.

The success or failure of a CCAA restructuring is dependent on approval by the debtor companies' creditors and is subject to sanction by the overseeing court. Accordingly, a CCAA applicant can propose anything that is permitted by law to form part of a contract to its creditors in the applicant's Plan. A class of creditors will be bound by a Plan if: (i) creditors in that class vote to approve the Plan by a "double majority" – both a majority in number of voting claims and two-thirds majority in the total value of the voting claims; (ii) the court then sanctions the Plan; and (iii) the Plan is implemented.[30]

In sanctioning a Plan, a court will consider if: (i) there has been strict compliance with all statutory requirements throughout the CCAA process; (ii) anything has been done or purported to be done which is not authorised by the CCAA; and (iii) the Plan is "fair and reasonable".[31]

In assessing whether a Plan is "fair and reasonable", the court will consider the following:

- whether the claims were properly classified and whether the requisite majority of creditors approved the Plan;
- what creditors would receive in a bankruptcy or liquidation as compared to the Plan;
- alternatives available to the Plan and bankruptcy;
- oppression of the rights of creditors;
- unfairness to shareholders; and
- the public interest.[32]

3. Duty to initiate insolvency process

In Canada, directors do not have a positive obligation to file a company for bankruptcy or insolvency protection. However, if directors do not fulfill their fiduciary obligations, including the duty of care, or act in an oppressive manner, they may be subject to civil liability.

4. Legal certainty and predictability

4.1 Legal certainty and predictability to local creditors

Given that Canadian directors do not have a positive obligation to file a company for bankruptcy or insolvency protection, the concept of a insolvency practitioner (IP) in a foreign country relieving directors of any such obligation and the associated certainty and predictability provided to local creditors is not applicable in Canada.

[30] CCAA, s 6(1).
[31] *Re Canadian Airlines Corp,* 2000 ABQB 442, [60]; *Re Sammi Atlas Inc,* [1998] OJ No 1089, 3 CBR (4th) 171 (Ont SCJ), [2]; *Re Canwest Global Communications Corp,* 2010 ONSC 4209, [14]; *Re Skylink Aviation,* 2013 ONSC 2519, [26].
[32] *Re Canwest Global Communications Corp,* 2010 ONSC 4209, [21].

4.2 Communications with local courts and creditors

Pursuant to section 23 of the CCAA, the monitor in a CCAA proceeding must generally publish a notice containing certain prescribed information once a week for two consecutive weeks in at least one Canadian newspaper.[33] After an initial CCAA order is granted by the court, the monitor must make such order publicly available within five days and notify every known creditor with a claim of over CAD $1000 that the order is publicly available.[34] The monitor must also create a list with the details of each creditor and the estimated amounts of the creditors' claims, which must also be made publicly available.[35]

The monitor has other reporting obligations under the CCAA regarding items such as: the debtor's cash-flow statements; any appraisals or investigations regarding the debtor's business and financial affairs; certain material adverse changes with respect to the debtors' business and financial affairs; the first meeting of creditors of the debtor; and anything else the monitor understands to be necessary.[36] All of the monitor's reports must be made publicly available in the prescribed manner under the CCAA and in the time period(s) described under the CCAA for creditors and any other stakeholders or interested parties to review.[37]

4.3 Guarantees by the IP in office

The monitor in the main CCAA proceedings is not required to provide any guarantees pending the debtor's restructuring procedure. The CCAA does not mention a monitor's obligation to provide a guarantee.

5. Consolidation of assets

5.1 Procedure with respect to the sale of the whole or part of a business

In a CCAA restructuring or BIA proposal, the debtor company is free to pursue and negotiate a sale of its assets. However, court approval is required for any sale or disposition of assets outside the ordinary course of business. The sale is not put to creditors or shareholders for approval but is subject to the court's review and approval. The debtor company is required to give notice of a motion seeking an approval and vesting order to all secured creditors likely to be affected by the proposed sale or disposition. Creditors or shareholders may oppose the sale before the court.

The legal test for obtaining court approval is set out in the CCAA and BIA.[38] In deciding whether to grant authorisation of the sale, the court is to consider the following non-exhaustive list:

- whether the process leading to the proposed sale or disposition was reasonable in the circumstances;

[33] CCAA, s 23(1)(a).
[34] *Idem*, s 23(1)(a).
[35] *Idem*, s 23(1)(a).
[36] *Idem*, s 23(1).
[37] *Ibid*.
[38] CCAA, s 36 and BIA, s 65.13.

- whether the monitor approved the process leading to the proposed sale or disposition;

- whether the monitor filed with the court a report stating that in their opinion the sale or disposition would be more beneficial to the creditors than a sale or disposition under a bankruptcy;

- the extent to which the creditors were consulted;

- the effect of the proposed sale or disposition on the creditors and other interested parties; and

- whether the consideration to be received for the assets is reasonable and fair, taking into account their market value.[39]

The court will consider additional factors when a potential sale of assets is to a related person. For the purpose of this analysis, the CCAA includes in the definition of "related persons": (i) a director or officer of the company; (ii) a person who has or has had, directly or indirectly, control in fact of the company; and (iii) a person who is related to a person described in (i) or (ii).[40]

If the proposed sale or disposition is to a person who is related to the company, the court may grant authorisation only if it is satisfied that: (i) good faith efforts were made to sell or otherwise dispose of the assets to persons who are not related to the company; and (ii) the consideration to be received is superior to the consideration that would be received under any other offer made in accordance with the process leading to the proposed sale or disposition.[41]

5.2 Difference in treatment with respect to tangible and intangible assets

The sale process described in section 5.1 is identical with respect to tangible and intangible assets.

5.3 Role of the creditors and the creditors' committees in a substantive consolidation

In a sale of the assets under the CCAA or BIA, there is no creditor vote, but rather the debtor corporation is required to seek and receive court approval for the asset sale. Any creditors, regardless of their classification, who are opposed to the sale can object and make submissions to court based on the criteria set out above.

6. Equitable distribution and accountability of IPs

In Canadian restructuring and insolvency law, a cram down on creditors (other than those holding equity claims) is not available. When seeking an order of the court calling for a meeting of the creditors to vote on a proposed Plan, the debtor must propose and defend its classification of creditors. Creditors with similar interests are grouped together while other creditors may be classified in separate groups. A Plan can only be binding on those creditor classes that vote to accept the Plan by the

[39] CCAA, s 36(3).
[40] *Idem*, s 36(5).
[41] *Idem*, s 36(4).

required majorities – the debtor does not have the option to force the outcome down on subsequent creditor groups.

A bail-in is a possibility. Debt-for-equity swaps are available as shareholders or equity claims may be compromised without the benefit of a formal meeting or vote. No payments are permitted under a Plan to shareholders or holders of equity claims until the debtor corporation's creditors are paid in full.

7. Intercompany claims

7.1 Order of priority

The BIA contains provisions that postpone certain claims against a debtor. Pursuant to section 137 of the BIA, a non-arm's length creditor that enters into a transaction with a debtor before the debtor's bankruptcy is not entitled to a distribution from the estate in respect of that transaction until all other creditors' claims are satisfied unless, in the opinion of the court or the trustee in bankruptcy, the transaction was a "proper transaction".

Claims of silent partners are postponed to the claims of other creditors pursuant to section 139 of the BIA, which provides that a lender that advances money to a debtor in connection with a trade or business deal in exchange for a rate of interest based on a debtor's profits is not entitled to recover anything on the loan until the claims of all other creditors have been satisfied.

Pursuant to section 140.1 of the BIA, no equity claim may be paid until all creditor claims are satisfied. Similarly, section 6(8) of the CCAA provides that a court cannot sanction a Plan that provides for the payment of equity claims before creditors are paid in full.

Under section 22(3) of the CCAA, a creditor that is related to the debtor company can vote against but not for the debtor company's Plan.[42]

7.2 Concepts that can alter priority

The Supreme Court of Canada has yet to determine whether or not equitable subordination exists in Canada. However, in a recent decision, *Re US Steel Canada Inc,* the Ontario Court of Appeal (ONCA) held that equitable subordination is not available under the CCAA.[43] In its reasons for decision, the ONCA noted that equitable subordination may be available under the BIA.[44] To this end, at least one Canadian court has applied equitable subordination in a bankruptcy proceeding.[45] However, the concept of re-characterisation does exist under Canadian law. To determine whether or not debt should be re-characterised as equity, courts apply a two-part test: (i) did the lender subjectively expect to be repaid principal and interest from the borrower's cash flow over the term of the loan at the time the lender made the loan; and (ii) was the lender's expectation objectively reasonable?[46]

[42] The definition of a related person is found at BIA, s 4.
[43] *Re US Steel Canada Inc,* 2016 ONCA 662, leave to appeal to SCC granted.
[44] *Idem*, [104].
[45] *Lloyd's Non-Marine Underwriters v JJ Lacey Insurance Ltd*, 2009 NLTD 148; *Re General Chemical Canada Ltd,* [2006] OJ No 3087, 150 ACWS (3d) (Ont SCJ), aff'd 2007 ONCA 600.
[46] *Re US Steel Canada Inc,* 2016 ONCA 662, leave to appeal to SCC granted.

In applying the two-part test, courts will consider the economic circumstances under which the loan was made.[47]

8. Administering a complex estate in one single consolidated procedure

The CCAA is a flexible statute and can be used to administer complex corporate group restructurings, regardless of the size and structure of the corporate group. The statute does not require that an entire corporate group file for CCAA protection.

The flexibility of the CCAA permits an entire corporate group to be restructured in a single proceeding. Alternatively, and if appropriate under the circumstances, a corporate group may be restructured in more than one proceeding under the CCAA.

9. Handling an insolvent parent with a healthy subsidiary

Generally, solvent subsidiaries will not be consolidated with an insolvent group as Canada's restructuring and insolvency system operates almost completely on an entity-by-entity basis. However, where the entities are so intermingled such that the solvent entity must be brought in from a practical procedural basis, it is possible.

For example in *Re First Leaside Wealth Management*[48] (*First Leaside*), a real estate syndicate, First Leaside Group (FLG), sought an initial order under the CCAA to undertake an orderly wind-down. Some of the FLG applicant entities were "debtor companies" within the scope of the CCAA in the sense that they were insolvent. However, other applicants were solvent and did not satisfy the definition of a debtor company under the CCAA.

The Ontario Court held that it was both necessary and appropriate to extend CCAA protection to all the applicant entities, as well as the limited partnerships, as the presence of all the entities within the ambit of the initial order was necessary to effect the orderly winding-up of FLG. This conclusion was supported by the overall insolvency of FLG and the high degree of inter-connectedness among the entities in the group. As a result of the structure of the business and the circumstances of FLG as a whole, it was a procedural necessity that all entities be brought into the CCAA process.

There was no need to distinguish as to whether a particular entity fell under the initial order as a "debtor company" within the meaning of the CCAA or was simply a necessary party as part of the intertwined whole.

First Leaside is the exception to the general rule in Canada, but it demonstrates the flexibility of the CCAA in responding to circumstances in which solvent subsidiaries may appropriately be part of an insolvency proceeding.

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[47] *Ibid.*

[48] *Re First Leaside Wealth Management Inc,* 2012 ONSC 1299.

CAYMAN ISLANDS

1. Consolidated group restructurings versus cooperation or coordination procedure

There is no formal legislative framework within the principal statutes comprising Cayman Islands insolvency law providing for consolidated group restructurings.

The Financial Services Division of the Grand Court of the Cayman Islands (Grand Court), which holds jurisdiction over the Grand Court-supervised liquidation of Cayman Islands entities,[1] can order that the liquidation proceedings of two or more Cayman Islands entities will be *heard* together, but it will not make an order for such liquidation proceedings to be *consolidated*.[2] The hearing of applications together in this manner would typically occur in the interests of administrative and cost efficiency, and where there is a sufficient inter-group convergence of interests so as to ensure that the welfare of each entity's insolvent estate would not be prejudiced as a result. In practical terms, this would mean the appointment of the same liquidator over a number of Cayman Islands entities within the same corporate group[3] and, to the extent that it is possible to do so, the simultaneous disposal of Grand Court applications required to be made in relation to the affected liquidations. The Grand Court might also, for example, order that one or more related liquidations be stayed until after the determination of another related action where a common question of law or fact has arisen. It should be clear that this exercise of the Grand Court's discretion is undertaken in pursuance of efficient, cost-effective liquidations; it is not an example of and does not have the effect of the consolidation of a group's assets and / or liabilities.

Allowance is made in the Cayman Islands Companies Winding Up Rules (as revised) (CWR) for the Grand Court-supervised liquidator of a Cayman Islands entity to consider whether or not it is appropriate to enter into a specific protocol with officeholders appointed by a foreign court or authority over a foreign entity within the same group, in order to ensure the efficient, concurrent administration of two separate liquidation proceedings in separate jurisdictions. The intention of such a protocol is further detailed in Practice Direction No. 1 of 2018 (Court-to-Court Communications and Cooperation in Cross-Border Insolvency and Restructuring Cases), which provides that:

> "the purpose of such protocol is to promote the orderly administration of the estate of the company to avoid duplication of work and conflict between the official liquidator and the foreign officeholder … These include procedures for the exchange of information between the officeholders; procedures for reporting to creditors and / or contributories and procedures for coordinating sanction applications made to the Grand Court and the foreign court."

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1 For the purpose of this chapter, "entity" can be taken to include an exempted limited company, an exempted limited partnership, or a limited liability company. Although there are key distinctions between these types of vehicles, those distinctions are beyond the scope of the topic in discussion. In the interests of simplicity, this chapter will use the exempted limited company as the model (save where otherwise indicated).

2 CWR, o 24 r 1(5) provides: "The Court may hear two or more petitions at the same time, but it shall not make any order for two or more petitions to be consolidated."

3 Although there is no statutorily enshrined definition of corporate "group" under the applicable Cayman Islands law, for the purpose of this chapter the term will be taken as referring to "a parent undertaking and all its subsidiary undertakings", being a "group of companies" as defined in Regulation (EU) 2015/848 of the European Parliament and the Council of 20 May 2015 on Insolvency Proceedings (EIR Recast).

The courts of many English-speaking countries, in particular the United States, the United Kingdom and Hong Kong, have recognised Cayman Islands liquidators and approved inter-jurisdictional protocols on many occasions since the mid-1980s.[4] Likewise, the Grand Court has approved the entry of Cayman Islands liquidators into cross-jurisdictional protocols for the same reasons.[5]

It should be noted that where there is no decided Cayman Islands' authority on a particular matter, English authorities, though not technically binding, would be regarded as persuasive by the Grand Court.[6] It would be unusual if the Cayman Islands' courts were not to follow the English authorities on a particular point in circumstances where no relevant Cayman Islands' authority existed unless there was a material divergence (including, without limitation, where there is a specific statutory provision relevant to a particular point) between the two jurisdictions.

1.1 Corporate group versus individual legal entity

The general principles regarding corporate personality under English law have persuasive authority in the Cayman Islands. The legal principle of separate legal personality established in the English case of *Salomon v Salomon & Co*[7] is respected and has been applied by the Cayman Islands courts.

It is only in exceptional circumstances that the Cayman Islands courts may consider it appropriate to supersede this principle by "piercing the corporate veil", which entails attributing liability to a shareholder directly. The circumstances in which the courts will pierce the corporate veil are limited and usually relate to cases of fraud, whereby a shareholder deliberately interposes a corporate entity for improper purposes (such as to evade a liability), and the courts will not pierce the corporate veil in pursuance of general group restructurings.

1.1.1 The insolvency and restructuring systems that are in force

In the Cayman Islands, the Companies Act (as revised) (Companies Act), the CWR, the Exempted Limited Partnership Act (as revised), the Partnership Act (as revised) and the Grand Court Rules 1995 (Revised Edition) do not characterise multiple entities under the control of an entrepreneur as a single legal entity. Rather, the concept of separate legal personality is respected by Cayman Islands statutes and courts.

1.1.2 Definition of a corporate group

The only Cayman Islands legislation which specifically contains a definition referable to a corporate group is the Cayman Islands Stock Exchange Listing Rules (Listing Rules). A "group" is defined in the Listing Rules as "the issuer and its subsidiaries, if any". An "issuer" in the Listing Rules is defined as "an entity, such as a company, limited partnership or unit trust, the securities of which are the subject of an application for listing, or any of the securities of which are already listed."

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[4] G J Cleaver and A J Jones, "Recognition and Cooperation in Cross-Border Insolvency Matters" (29 May 2002), [3.3].

[5] See, for example, *In the Matter of Lancelot Investors Fund Ltd* [2009] CILR 7.

[6] See, for example, the *dicta* of the Cayman Islands Court of Appeal in *Miller v R* [1998] CILR 161. Zacca P, delivering the judgment of the court, said at 164: "A decision of the English Court of Appeal, while not formally binding upon this court automatically, is necessarily one of great persuasive authority, especially where it is unanimous and is directed towards a doctrine of the common law."

[7] [1897] AC 22.

In the case of *Fortuna Development Corporation*,[8] the Grand Court made an order appointing inspectors[9] over a Cayman Islands holding company. The order expressly authorised the inspectors to examine the affairs of the holding company's subsidiaries which were incorporated in other countries. The inspectors were appointed under section 64 of the Companies Act for the purpose of investigating allegations of misappropriations of dividends on the basis that "the usefulness of the investigation would be nullified if the inspectors were required to confine their investigation to the books and records of the [parent] company itself." This case exemplifies the reality that many Cayman Islands companies are holding companies, with few assets other than shares in subsidiary companies and few operations in the Cayman Islands other than as necessary to maintain the good standing of the holding company, but demonstrates that the Grand Court does recognise the commercial exigencies that may face independent fiduciaries (such as inspectors or liquidators) appointed over such holding companies. In circumstances where a liquidator is required to assume control over one or more subsidiaries, the Grand Court can grant powers that enable the liquidators to remove and replace directors of subsidiaries.

1.1.3 Legislation relating to corporate groups

While the authors are aware of certain proposed legislative changes that may come into effect in the short to medium term regarding Cayman Islands insolvency and restructuring law, the proposed changes do not make provision for the introduction of a statutorily enshrined concept of a group.

1.2 Corporate group versus individual corporate benefit

Whereas most corporate laws provide for one single entity, one corporate purpose and one corporate benefit, the reality seems to have moved away from the theory. For example, in the case of upstream guarantees, there exists a rule of thumb in practice that the guarantee provided by the subsidiary should not exceed 75% (in the case of an entity with employees) or 90% (in the case of a holding company) of the net assets of the subsidiary.

1.2.1 The existence and relevance of "corporate group benefits"

The question of corporate benefit falls within the purview of directors' duties: in taking any corporate action, a director of a Cayman Islands company is subject to a duty to act in what he or she *bona fide* considers is the best interests of the company.

"Corporate benefit" is not defined by statute: it is a commercial rationalisation that directors must undertake on a case-by-case basis, and in relation to which they are obliged to consider the company they direct only and not associated companies, subsidiaries or holding companies. "Corporate group benefit" is not therefore recognised under Cayman Islands law, and accordingly directors must undertake the same case-by-case analysis in every circumstance to determine if the contemplated transaction is in the best interests of that company, including where the company is requested to provide an upstream or downstream guarantee.

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8 In *Re Fortuna Development Corporation* [2004–05] CILR 197.

9 The Grand Court has jurisdiction to order the appointment of inspectors as alternative relief to a winding up, where a winding up petition is brought on the basis that it is "just and equitable" for the subject entity to be wound up.

There is no difference in the test to be applied to an upstream guarantee or a downstream guarantee. In each case, the directors of the company considering providing the guarantee must determine that it is in the best interests of that particular company to provide that particular guarantee.

As regards *de facto* directors, there is no statutory definition of a *de facto* director in the Cayman Islands. However, at common law, a *de facto* director is someone who assumes to act as a director, although never being actually or validly appointed (per Millet J in *Re Hydrodam (Corby) Ltd*).[10] While the *Re Hydrodam* case is not strictly binding in the Cayman Islands, as explained above, it would likely be persuasive.

In contrast, there is a statutory definition of a shadow director in the Cayman Islands found in section 89 of the Companies Act, being any person in accordance with whose directions or instructions the directors of the company are accustomed to act (but noting that a person is not deemed to be a shadow director by reason only that the directors act on advice given by such and individual in a professional capacity).

In addition, under Cayman Islands law, a director of a company may itself be a body corporate.

While the authors are not aware of any Cayman Islands reported cases considering this point, in theory, it is possible for a shareholder to be considered a *de facto* director to the extent that such a shareholder assumes to act as a director notwithstanding that the shareholder was never actually or validly appointed as a director.

In addition, and again noting that the authors are not aware of any Cayman Islands reported cases considering the point, in theory it is possible for a shareholder to be considered a shadow director to the extent that the directors of the subsidiary are accustomed to act in accordance with the directions or instructions of the shareholder.

1.2.2 Director liability

As indicated above, a director of a Cayman Islands company owes his or her duties to that company alone. While it is often the case that the interests of one entity may align with the interests of another entity in the same group, directors must ensure that actions they take accord with their fiduciary duties to the particular company of which they are a director.

It appears to be settled English law (which would likely be persuasive in the Cayman Islands) that as long as an act is within the objects of a company, it will not be invalidated merely because it was not of any discernible benefit to the company or its business:

> *"The objects of a company do not need to be commercial; they can be charitable or philanthropic; indeed, they can be whatever the original incorporators wish, provided that they are legal. Nor is there any reason why a company should not part with its funds gratuitously or for non-commercial reasons if to do so is within its declared objects …"*[11]

[10] [1994] 2 BCLC 180.
[11] *Horsley & Weight Ltd* [1982] Ch 442, per Buckley LJ, 450E-452G.

In the case of a company incorporated under the Companies Act, an act will be within the objects of the company if it is expressly or impliedly set out in its memorandum of association. An act may be implied into the memorandum of association if it is reasonably incidental to the attainment or pursuit of any of the express objects.[12] Since the objects of a Cayman Islands company are not required to state the objects of the company, in the absence of specified objects, the company has full power and authority to carry out any objects not prohibited by law.[13]

Provided the transaction is not *ultra vires* or a fraud on creditors, a director who wishes to pursue a course of action which, while beneficial to the broader corporate group, is not of discernible benefit to the company he or she directs, may seek to insulate himself or herself from liability for breach of duty by obtaining approval for a proposed course of action from all shareholders entitled to vote at a general meeting of the company he or she directs.

1.2.3 "Early warning systems"

Although Cayman Islands directors are required to be constantly aware of their fiduciary duties and how these duties shift towards the interests of creditors if the company approaches "the twilight of insolvency", no legislation or formal convention exists which establishes an "early warning system", pursuant to which directors are bound to take certain corporate actions upon the occurrence of a commonly acknowledged triggering event such as, for example, the exceeding of a predetermined asset to liability ratio. In other words, there is no prescribed point by which Cayman Islands directors must commence an insolvency or restructuring process.

However, Cayman Islands directors may be held personally liable to the company for any losses which they cause the company to incur in breach of their fiduciary duties – for example, if they continue to direct the company in such manner as it incurs additional liabilities at a time when the directors knew (or ought to have known) that there was no reasonable prospect of the company avoiding insolvent liquidation.

1.2.4 Pending or draft legislation

While the authors are aware of certain proposed legislative changes that may come into effect in the short to medium term regarding Cayman Islands insolvency and restructuring law, to the best of their knowledge, the proposed changes do not deal with this issue (as explored in further detail below).

1.3 Universalism versus territorial principle

1.3.1 Application of the modified universalism rules[14]

The principle of modified universalism is recognised in the Cayman Islands in the context of cross-border restructuring and insolvency matters, and this is reflected both in Cayman Islands statutory law and case law (as explored in further detail below).

[12] *Idem*, 448.
[13] Companies Act, s 7(4).
[14] EIR Recast.

1.3.2 Bilateral and / or multilateral treaties in force

The Cayman Islands has not implemented the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency (1997) (Model Law) and is not party to any other international treaty or law concerning cross-border insolvency and restructuring matters.

However, the Grand Court has jurisdiction to wind up a foreign company which is property located[15] in the Cayman Islands, is carrying on business in the Cayman Islands, is the general partner of a Cayman Islands limited partnership, or is registered as an overseas company under Part IX of the Companies Act. In addition, relevant statutory provisions contained in Part XVII of the Companies Act,[16] as supplemented by the Foreign Bankruptcy Proceedings (International Cooperation) Rules 2018 (International Cooperation Rules), provide for the recognition of, and giving of assistance in respect of, foreign bankruptcy proceedings.

Under Part XVII, the Companies Act permits, but does not oblige, the Grand Court to make orders ancillary to a foreign bankruptcy proceeding for a number of specified purposes, including: recognising the right of a foreign representative to act in the Cayman Islands on behalf of or in the name of a debtor; enjoining the commencement or staying the continuation of legal proceedings against a debtor; staying the enforcement of any judgment against a debtor; requiring a person in possession of information relating to the business or affairs of a debtor to be examined by and produce documents to its foreign representative; and ordering the turnover to a foreign representative of any property belonging to a debtor (together, Ancillary Orders).[17]

For these purposes, a "debtor" is defined as a foreign corporation or other foreign legal entity subject to a foreign bankruptcy proceeding in the country in which it is incorporated or established; a "foreign bankruptcy proceeding" is defined as including proceedings for the purpose of reorganising or rehabilitating an insolvent debtor; and a "foreign representative" means a trustee, liquidator or other official appointed in respect of a debtor for the purposes of a foreign bankruptcy proceeding.

The Grand Court is therefore permitted to provide ancillary support to a foreign bankruptcy proceeding in the jurisdiction in which the foreign debtor is incorporated or is established. Notably, a debtor under Part XVII of the Companies Act does not include a Cayman Islands company which is the subject of a foreign bankruptcy proceeding. It follows that the seeking of the assistance of the Grand Court to implement a foreign bankruptcy proceeding, such as a proceeding under Chapter 11 of the United States Bankruptcy Code in respect of a Cayman Islands company, would not fall within the regime contemplated by Part XVII of the Companies Act.

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[15] As to whether a company has property located in the Cayman Islands, the position is relatively simple in relation to tangible property (e.g. real estate and chattels which are physically located in the Cayman Islands). However, the position as regards intangible property is more complicated, and to determine if intangible property is "located" in the Cayman Islands it would be necessary to determine that the *lex situs* of the relevant intangible property (determined in accordance with Cayman Islands' conflict of laws principles) is in the Cayman Islands. For example, under Cayman Islands' conflict of laws principles, the *lex situs* of shares of a Cayman Islands company may, in circumstances where the register of members is located outside of the Cayman Islands, be in a jurisdiction other than the Cayman Islands.

[16] Companies Act, ss 240-243.

[17] *Idem*, s 241.

In determining whether to exercise its discretion to make an Ancillary Order, the Grand Court is required[18] to be guided by matters which will assure an economic and expeditious administration of the debtor's estate, consistent with a number of principles. These principles include: the just treatment of all holders of claims against or interests in a debtor's estate wherever they may be domiciled; the protection of claim holders in the Cayman Islands against prejudice and inconvenience in the processing of claims in the foreign bankruptcy proceeding; the prevention of preferential or fraudulent dispositions of property comprised in the debtor's estate; the distribution of the debtor's estate amongst creditors substantially in accordance with the order prescribed by Part V of the Companies Act which, broadly, requires the *pari passu* distribution of assets amongst the debtor's creditors; the recognition and enforcement of security interests created by the debtor; the non-enforcement of foreign taxes, fines and penalties; and comity.

In addition, section 242(2) requires that, where a debtor is registered as an overseas company under Part IX of the Companies Act, the Grand Court shall not make an Ancillary Order without also considering whether it should make a winding-up order under Part V of the Companies Act in respect of the subject company's local branch pursuant to the above-noted provisions of Part V of the Companies Act, which permits the Grand Court to wind up a foreign company.

In addition, outside of the above statutory provisions, the approach of the Grand Court has been supportive of principles of comity and universalism in cross-border restructuring and insolvency cases. Representative Cayman Islands cases in this area include the following:

(a) *Kilderkin v Player*.[19] This case concerned the recognition in the Cayman Islands of the appointment of a receiver and manager by the Supreme Court of Ontario in respect of a company incorporated in Ontario, Canada, for the purpose of identifying and locating assets of the company in the Cayman Islands. Recognition was granted subject to the finding of a sufficient connection between the company and the jurisdiction in which the receiver was appointed to justify recognition of the foreign court's order. The case is an early example of the Grand Court adopting a universalist approach in cases where assets are held by a company in a jurisdiction other than the jurisdiction of the primary proceedings.

(b) *Bank of Credit & Commerce International (Overseas) Ltd*.[20] In this fact-specific and, at the time, somewhat unprecedented case, the Grand Court exercised its discretion to approve a pooling arrangement agreed between the liquidators of the Cayman Islands bank, BCCI, and an associated Luxembourg company, pursuant to which assets recovered in the separate liquidations would be pooled and available for distribution to creditors globally on a pro-rated basis. In the circumstances of being requested to sanction such a pooling arrangement, the Grand Court held it to be important and in the best interests of the creditors that the Grand Court should cooperate in enabling the assets of the group worldwide to be salvaged as far as possible and made available to creditors.

[18] *Idem*, s 242.
[19] *Canadian Arab Financial Corporation (trading as Kilderkin Investments Grand Cayman) and Kilderkin Investments Ltd (both by Clarkson Company Ltd, receiver and manager) v Player* [1984–85] CILR 63.
[20] *In re Bank of Credit & Commerce International (Overseas) Ltd Credit & Fin Corp Ltd and International Credit & Inv Co (Overseas) Ltd* [1992] CILR Note 7A.

(c) *Lancelot.*[21] In this case, a Cayman Islands open-ended investment fund with United States creditors and a United States investment manager had filed for bankruptcy in the United States and a trustee had been appointed under Chapter 7 of the United States Bankruptcy Code who then claimed to have exclusive jurisdiction over all of the company's assets. Certain investors petitioned the Grand Court for a Cayman Islands winding up order on the ground that, as a result of an alleged fraud carried on by the company's directors, the substratum of the company had failed, and therefore it was just and equitable that the company be wound up in the Cayman Islands, being the jurisdiction in which the company was domiciled, and notwithstanding the ongoing Chapter 7 proceedings. The Grand Court recognised, for a variety of reasons, that the United States was the principal place for the company's liquidation but also accepted that the petitioning creditors were entitled on the facts to a Cayman Islands winding up order in respect of the company. However, the Grand Court only appointed a single Cayman Islands liquidator rather than the more usual two joint liquidators with a view to preserving the ability of the US Chapter 7 trustee to seek recognition of his appointment in the Cayman Islands. In addition, and having regard to the principle of universalism, the Grand Court ordered that the winding up order would be stayed to enable the Cayman Islands official liquidator and the Chapter 7 trustee "a proper and full opportunity to discuss their respective roles and, if possible, to agree a protocol". *Lancelot* is a clear example of the Grand Court adopting a modified universalist approach by balancing the principle of universalism mitigating in favour of a single system of distribution of the company's assets in the place of its principal liquidation against the protection of the interests of creditors under Cayman Islands law.

(d) *Trident Microsystems.*[22] This case concerned a company incorporated in the Cayman Islands which, together with its Delaware incorporated parent, had filed for protection under Chapter 11 of the United States Bankruptcy Code in Delaware. In addition, Cayman Islands joint provisional liquidators were appointed over the company for the purpose of supporting the Delaware bankruptcy proceedings and facilitating the orderly implementation of any plan of reorganisation within such Delaware bankruptcy proceedings. A cross-border insolvency stipulation was concluded following a joint hearing between the Delaware Bankruptcy Court and the Grand Court. The protocol was stated by the Grand Court to provide "a framework for the cooperation between multiple jurisdictions" and to "eliminate, wherever possible, duplication of effort and to promote judicial economy and co-operation." A number of asset sales were subsequently approved by both the Grand Court and the Delaware Bankruptcy Court. Notably, in approving one such asset sale and having referred to the cross-border insolvency stipulation, the Grand Court observed that "this Court will continue to work in co-operation and co-ordination with Courts in other jurisdictions when appropriate to ensure the fair and efficient management of international insolvency proceedings in the interests of all creditors and other interested persons, including the debtor".

(e) *Ardent Harmony Fund Inc (In Official Liquidation).*[23] In this case, an investment fund constituted as a Cayman Islands exempted company was subject to official liquidation proceedings in the Cayman Islands. A significant creditor of the fund

[21] *In the matter of Lancelot Investors Fund Ltd* [2009] CILR 7.

[22] *In the matter of Trident Microsystems (Far East) Ltd* [2012] (1) CILR 424.

[23] *Re Ardent Harmony Fund Inc (In Official Liquidation)*, Grand Court, ASCJ, unreported, 31 May 2016, Cause No FSD 54 of 2016 (ASCJ).

commenced proceedings against the fund in Barbados, seeking a winding-up order in respect of the fund in Barbados. The liquidators made an application to the Grand Court for an order restraining the creditor from continuing the proceedings it had initiated in Barbados, and the Grand Court granted such order. In granting the order, and demonstrating an approach reflective of the principle of modified universalism, the Grand Court found that "the Court has jurisdiction to restrain a creditor over whom it has personal jurisdiction from the institution or continuance of proceedings in a foreign court, where the effect of those proceedings would be to subvert the universal collective process of liquidation."

1.3.3 Pending legislation

As noted above, the authors are aware of certain proposed legislative changes regarding Cayman Islands insolvency and restructuring law, which are expected to come into effect during the course of 2022. The proposed changes principally relate to the creation of a new restructuring moratorium proceeding under Cayman Islands law to better facilitate restructurings and to differentiate restructurings from winding up proceedings.

So far as the authors are aware, the proposed legislative changes do not relate to the law regarding the recognition of, and granting of assistance to, foreign proceedings, nor are they aware of any proposed changes to Part XVII of the Companies Act or to the International Cooperation Rules, for example. However, it is expected that the introduction of the restructuring moratorium proceeding under Cayman Islands law will facilitate the assistance and recognition of schemes of arrangement promoted by restructuring officers in foreign law jurisdictions that have implemented the UNCITRAL Model Law (a scheme of arrangement promoted outside of a provisional liquidation proceeding or restructuring moratorium proceeding being a corporate process which is not necessarily capable of recognition in foreign law jurisdictions).

1.4 Competent court and applicable law

The Grand Court has jurisdiction over corporate insolvencies in the Cayman Islands. Specifically, the Grand Court has jurisdiction to make winding-up orders in relation to a statutorily prescribed list of companies, comprising: an existing company; a company incorporated and registered under the Companies Act; a body incorporated under any other Cayman Islands law; and a foreign company which has property located in the Cayman Islands, is carrying on business in the Cayman Islands, is the general partner of a limited partnership or is registered as a foreign company under Part IX of the Companies Act.[24] A foreign company for the purpose of Part IX of the Companies Act means, post-1 December 1961, an overseas company which establishes a place of business or commences carrying on business within the Cayman Islands, noting that stated, non-exclusive, examples of such include the sale by or on behalf of an overseas company of its shares or debentures and offering, by electronic means, and subsequently supplying, real or personal property, services or information from a place of business in the Cayman Islands or through an internet service provider or other electronic service provider located in the Cayman Islands.

In addition, under Part XVII of the Companies Act and the International Cooperation Rules, as noted above, the Grand Court has the power to make orders ancillary to a foreign bankruptcy proceeding, for which purposes a "debtor" is defined as a foreign

[24] Companies Act, s 91.

corporation or other foreign legal entity subject to a foreign bankruptcy proceeding in the country in which it is incorporated or established.

It can therefore be seen that the determination of whether the Grand Court has jurisdiction to wind up a company is not based upon any concept of a centre of main interests (COMI). Similarly, the jurisdiction of the Grand Court to make orders ancillary to a foreign bankruptcy proceeding is not subject to a determination of COMI and, instead, is determined by reference to proceedings taking place in the country in which the company is incorporated or established, which may not be the country in which the company has its COMI.

Purely domestic insolvency proceedings are comparatively rare in the Cayman Islands. The majority of the jurisdiction's financial services market is attributable to foreign-owned corporate entities incorporated in the Islands on an "exempted" basis (i.e. carrying on business overseas). Consequently, cross-border corporate insolvencies constitute the majority of cases under the supervision of the Grand Court.

Part XVII of the Companies Act supplements and partially codifies the traditional English common law rule that the Grand Court will recognise the authority of a liquidator or trustee appointed under the law of the country of incorporation. To that extent, the Grand Court has recognised that it has no power under Part XVII of the Companies Act to provide judicial assistance upon the application of a foreign representative of an insolvent company appointed by a court in any country other than the country of its incorporation.[25] However, in appropriate circumstances and *not* pursuant to Part XVII of the Companies Act, the Grand Court may also recognise and provide assistance to a foreign, non-Cayman Islands, liquidator of a Cayman Islands company. An example of such is the case of *China Agrotech Holdings Ltd* (*China Agrotech*),[26] wherein the Grand Court recognised the Hong Kong court-appointed liquidators of a Cayman Islands exempted limited company and authorised the foreign liquidators to make an application to propose a Cayman Islands scheme of arrangement for the company. The basis on which such recognition was granted was stated to be non-statutory and not in reliance upon what the Grand Court termed a rule of private international law that the Grand Court will recognise the authority of a liquidator or trustee appointed under the law of the country of incorporation. Rather, in *China Agrotech* the Grand Court held that its non-statutory jurisdiction at common law is not limited to recognising foreign liquidators appointed in the country of incorporation, and that the Grand Court has jurisdiction in certain circumstances to recognise and grant assistance to liquidators appointed by courts other than in the country of incorporation, subject to certain limitations.

1.4.1 *Applicable law that falls outside of the* lex fori concursus *and related issues*

Although the laws of the Cayman Islands will govern the Cayman Islands insolvency process,[27] given that Cayman Islands companies are frequently holding companies with businesses and assets outside of the Cayman Islands, inevitably matters may arise in a Cayman Islands liquidation that require reference to, or the application of, foreign laws.

[25] *Picard v Primeo Fund (in official liquidation)* [2013] 1 CILR 164, [13], and noting that such a point was not overruled by the Cayman Islands Court of Appeal on appeal in *Picard and Bernard L Madoff Investment Securities LLC (in liquidation) v Primeo Fund (in liquidation)* [2014] 1 CILR 403, [40].

[26] *In re China Agrotech* (2017) Grand Court, Segal J, unreported, 19 September 2017, Cause No FSD 157 of 2017 (NSJ).

[27] "Rule 19" of *Dicey, Morris & Collins on the Conflict of Laws* (Sweet & Maxwell, 15th ed, 2018).

Examples include where a company subject to a Cayman Islands insolvency process is party to a contract which is governed by non-Cayman Islands law and / or where the company is subject to the exclusive jurisdiction of a foreign court in respect of a contract. In such cases, disputes regarding that contract may need to be determined by reference to foreign laws or by the courts of a foreign country.

Similarly, a company subject to a Cayman Islands insolvency process will often own assets outside of the Cayman Islands and claims to such assets may fall to be determined by the foreign law governing such assets.

In a restructuring context, the Cayman Islands courts would likely look to the proper law of the debt to determine whether it has been discharged, as demonstrated by the decision of the Privy Council (on appeal from the Cayman Islands Court of Appeal) in *Wight and others v Eckhardt Marine GmbH*,[28] where the Privy Council held that a Bangladeshi law governed debt had been discharged under its governing law by a Bangladeshi scheme of reconstruction such that the debt could not form the basis of a proof of debt in the Cayman Islands liquidation of Bank of Credit and Commerce International (Overseas) Ltd.

Furthermore, following the introduction of the restructuring moratorium proceeding in the Cayman Islands, although untested, it is anticipated that the compromise of foreign law governed debt (e.g. English law or New York law governed debt) by way of a scheme of arrangement promoted by a restructuring officer will be capable of recognition in relevant jurisdictions that have implemented the UNCITRAL Model Law (i.e. notwithstanding the rule in *Gibbs*, a Cayman Islands scheme of arrangement promoted by a restructuring officer may be recognised and enforced in England as being capable and effective to compromise English law governed debt).

1.4.2 Harmonisation of substantive restructuring and insolvency laws

By offering relief to overseas insolvency practitioners (IPs), both pursuant to statute and at common law, and by encouraging the adoption of the cross-jurisdictional insolvency protocols noted above, it can be seen that the Cayman Islands has already adopted a form of modified universalism.

Clearly, further cross-border harmonisation may lead to efficiencies and cost-savings, but the Cayman Islands is already a jurisdiction that is well equipped to address the complexities involved with cross-border insolvency cases.

1.4.3 Applicable treaties and case law

These issues are discussed above.

An additional notable case is the first instance case of *Picard v Primeo Fund,*[29] and its subsequent appellate court decision,[30] in which the Grand Court rendered assistance to the US Bankruptcy Courts permissible, to the extent that it is capable of implementation within the confines of the provisions of Part XVII of the Companies Act.

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[28] *Wight, Pilling and MacKey v Eckhardt Marine GmbH* [2003] CILR 211.
[29] *Ibid.*
[30] *Picard and Bernard L Madoff Investment Securities LLC (in liquidation) v Primeo Fund (in liquidation)* [2014] 1 CILR 379.

While the Grand Court will offer forms of relief (by making ancillary orders) that are comparable to the modes of relief that exist in other jurisdictions (such as England and Wales and the United States), it will not extend powers to foreign representatives that would exceed the powers ordinarily available to Cayman Islands liquidators.[31]

1.4.4 Upcoming new legislation

The authors are not aware of any proposed legislative reforms that would introduce a concept of COMI into Cayman Islands law, nor are they aware of any proposed amendments to Part XVII of the Companies Act.

2. Substantive consolidated restructuring proceedings versus synthetic group restructurings

While it is possible for separate insolvency proceedings to be heard together where common questions of law or fact arise between them, this is not always appropriate for intra-group proceedings.

Commonly, Cayman Islands companies act as holding companies, so upon the commencement of liquidation, the role of the Grand Court-supervised liquidator will be to oversee the wind-down of the company by realising its investments and assets, including its subsidiary holdings. This may require the Cayman Islands liquidator to seek recognition in other jurisdictions or to seek ancillary relief in those jurisdictions, but it would not necessarily require the combination, consolidation or, potentially, the appropriation of assets located in other jurisdictions and held by entities with separate legal personality.

Since there is little need for them, neither "consolidated" corporate group proceedings nor synthetic "consolidated" group restructurings are commonly pursued under Cayman Islands law. In any event, there is no basis or precedent for the Grand Court to follow, applying the law of a member state, to incorporate into its judgment a replication of the potential outcome of a separate insolvency proceeding that has not taken place.

As a matter of practice, the prevalence of use of Cayman Islands exempted companies as special purpose vehicles for multi-jurisdictional business results in liquidators being appointed over Cayman Islands incorporated holding companies which have subsidiary entities incorporated or established in foreign jurisdictions. As such there is limited demand, if at all, for domestic consolidated corporate group insolvency legislation.

3. Duty to initiate insolvency process

The test for insolvency in the Cayman Islands is whether a company is able to pay its debts. There is no balance sheet insolvency test.

Where a company is insolvent or in the twilight of insolvency, the directors of the company continue to owe their duties to the company as a whole, but must consider the interests of the creditors of the company in priority to those of the shareholders due to the fact that the interests of the creditors would displace those of the shareholders in an insolvent liquidation. It is the fiduciary obligations of the company's

[31] *Picard v Primeo Fund (in official liquidation)* [2013] 1 CILR 164 [39]–[41].

directors to its shareholders and, where the company is facing the prospect of insolvency, to its creditors, that should guide the directors' determination of the appropriate course of action.

It would be a matter of directors' discretion whether the offer of a guarantee from the liquidator of a related, insolvent overseas entity[32] gave sufficient financial comfort as to the delay or prevention of the encroachment of insolvency. In deciding whether or not to rely on a guarantee, a director would likely require sight of a legal opinion which confirmed the validity and enforceability of such a guarantee, including confirmation that payments under it would constitute a priority expense of the overseas liquidation or equivalent, along with financial data confirming the ability of the overseas company to discharge its obligations under the guarantee.

Subject to considering, upon receipt of sufficient confirmatory advice, that the interests of the company are best served by accepting the guarantee from the liquidator of the related overseas company and thereby avoiding the value-eroding consequences of formal insolvency, the director of the Cayman Islands company may well determine that the interests of the company's creditors are better served by entering into and receiving the benefit of the guarantee.

4. Legal certainty and predictability

4.1 Legal certainty and predictability to local creditors

Not applicable.

4.2 Communications with local courts and creditors

Not applicable.

4.3 Guarantees by the IP in office

Not applicable.

5. Consolidation of assets

5.1 Procedure with respect to the sale of the whole or part of a business

In a Grand Court-supervised liquidation, the official liquidator is empowered (subject to the requirement to obtain the sanction of the Grand Court) to realise the assets of the company over which he or she is appointed by selling them by public auction or by private contract. In such cases, creditor or shareholder consent would not strictly be required (and neither would vote on the proposed sale), though the Grand Court would likely take into account the views of creditors (in the case of an insolvent official liquidation) or shareholders (in the case of a solvent official liquidation) in deciding whether or not to sanction a proposed sale of assets, most typically by the Grand Court having reference to the views of the members of the company's liquidation committee, if constituted. A liquidation committee is required to be constituted following the appointment of Grand Court-supervised liquidators. Broadly it serves

[32] We note that in the English case of *Collins and Aikman* [2005] EWHC 1754 (Ch) such a guarantee was held as sufficient to avoid the requirement to open ancillary insolvency proceedings. This case may be treated as persuasive in the Cayman Islands, although it has not yet been applied by the Grand Court in comparable circumstances.

two purposes: to represent the company's stakeholders in an advisory capacity; and to approve the liquidator's fees. While the advisory role carries no mandatory requirement for the liquidator to obey any opinions or resolutions of the liquidation committee, the liquidator, as a Grand Court-appointed fiduciary, is required to act in the interests of the creditors and will therefore seek to work with the liquidation committee and require it to guide the liquidation process by considering and voting on matters of significant import during the liquidation. Indeed, in many cases a liquidator will be required to seek the sanction of the Grand Court before selling assets. In sanction applications, the Grand Court will likely place significant weight on the views expressed by the liquidation committee regarding the subject disposal.

In cases where the company is clearly insolvent, the Grand Court is less likely to have regard to the views of shareholders, unless it can be demonstrated that the shareholders have, or may have, a continuing economic interest in the debtor.

Similarly, subject to the terms of the Cayman Islands court order appointing provisional liquidators, provisional liquidators may also have the power to realise the assets (in whole or in part) of the company over which they are appointed.

Outside the context of official or provisional liquidation proceedings, where a debtor is under the control of its directors or relevant managing entity (such as the general partner, in the case of a Cayman Islands limited partnership or exempted limited partnership), it will be at the discretion of such directors or relevant managing entity as to whether to sell the whole or part of the debtor's business. Outside of official or provisional liquidation, there is no prescribed statutory framework for such a sale which would directly enfranchise shareholders or creditors to vote on it. However, other relevant considerations may arise for the directors or managing entity, including whether there are relevant restrictions in the articles of association or other constitutional documents of the debtor or restrictions in any agreements, including finance agreements to which the debtor is party, which may restrict or place parameters around such a sale. In addition, to the extent that a company is insolvent, under Cayman Islands law its directors are required to act in the interests of the company's creditors.

In a restructuring context, a sale of a company's assets may be part of a compromise or arrangement to be presented to a company's creditors pursuant to a Cayman Islands scheme of arrangement under section 86 of the Companies Act. Following the introduction of the restructuring moratorium proceeding, a restructuring officer will also be enfranchised to promote a compromise or arrangement to a company's creditors pursuant to a Cayman Islands scheme of arrangement, with the benefit of the automatic moratorium on legal proceedings being continued or commenced by unsecured creditors against the company (such moratorium not currently applicable in respect of schemes of arrangement pursued outside of provisional liquidation proceedings).

A scheme of arrangement is an arrangement pursuant to which a compromise or arrangement may be proposed between a company and its creditors or shareholders (or any class of them) and which may, subject to the Grand Court's discretion, be sanctioned by the Grand Court following a positive vote in favour of the scheme of arrangement by a majority in number representing not less than 75% by value of those voting in each class of creditors or shareholders. In that regard, a Cayman Islands scheme of arrangement operates in a similar fashion to an English scheme of arrangement and can be used in an insolvency and restructuring context, so long as the minimum statutory majority of creditors vote in favour of it, to force a compromise on dissenting creditors.

A Cayman Islands scheme of arrangement cannot, however, be used to achieve a cross-class cram down. That means that where a company's creditors are split into different classes for voting purposes, the requisite consent of *each* class of creditors would be required to approve the scheme of arrangement, and the scheme of arrangement as a whole will fail if any one class of creditors fails to approve it.

However, where some classes of creditors or shareholders are "out of the money" and will not receive any entitlements under the scheme of arrangement, it may be possible to exclude them – for example, where a company is insolvent and its shareholders have no continuing economic interest in the company, it is likely that the shareholders would not vote on the proposed scheme of arrangement, even if part of the proposed compromise is to facilitate the transfer of the company's assets to a new corporate structure owned by the company's creditors, thereby disenfranchising the company's existing shareholders).

5.2 Difference in treatment with respect to tangible and intangible assets

As noted, there is no established doctrine in the Cayman Islands of substantive consolidation whereby, upon or following the commencement of insolvency or restructuring proceedings, the assets and liabilities of two or more related companies may be combined into a single estate. However, practical consolidation of the insolvency proceedings, including the coordinated sale of the assets of related debtors – whether tangible or intangible assets – may be achieved in other ways. It may, in certain circumstances, be possible and appropriate for the Grand Court to appoint the same licensed IPs as official liquidators of related group companies and for such official liquidators to propose a coordinated sale of that group's assets, subject to the approval of each sale by the Grand Court, if such a coordinated sale is in the best interests of the creditors of each company. Critically, notwithstanding that the sale of related group companies' assets may be coordinated, the proceeds of such sales will not ordinarily be pooled for distribution purposes, save for circumstances where it is appropriate for the Cayman Islands court to "pierce" the corporate veil.

In a restructuring context, it may be possible to synthetically "consolidate" the assets of a number of separate but related companies by way of interlinked schemes of arrangement in respect of each company. Such interlinked schemes of arrangement may, for example, release the claims of creditors against the existing companies within the group in consideration for a transfer of the assets of each company to a new consolidated entity and the issuance of new debt, equity or other rights or entitlements to creditors by the new entity. Another example would be where the scheme of arrangement would provide that the claims of creditors against each company would be released in consideration for claims being processed, and distributions being made in respect of such claims, on a consolidated group-wide basis. Such an arrangement may, while not strictly effecting a substantive consolidation of the assets of related companies, have a similar practical effect if the effectiveness of each scheme of arrangement is conditional upon the effectiveness of the other schemes of arrangement.

However, it is important to note that, while a consolidated effect may result, strictly a separate scheme of arrangement for each company would be required, and creditors would vote in accordance with their separate claims against each company. In other words, there would be no consolidation of votes, and creditors with claims against multiple companies within the same group would not vote on a group basis and instead would vote in relation to each separate company's scheme of arrangement. As such, in circumstances where the effectiveness of schemes of arrangement proposed by multiple companies are stated to be interdependent, such that all related schemes of arrangement must be approved in order for any one scheme of arrangement to become effective in accordance with its terms, a failure of the creditors of one company to approve a scheme of arrangement of that company would likely render all other proposed interdependent schemes of arrangement ineffective.

In addition, it is notable that there have been limited instances in which the Grand Court has approved pooling arrangements to give effect to a limited pooling of assets held by related debtor entities for the benefit of all creditors of such entities, as follows:

- Perhaps the most notable example of such an asset-pooling arrangement being approved by the Grand Court was in respect of the multi-jurisdictional insolvency of Bank of Credit & Commerce International (BCCI). BCCI concerned an insolvent bank operating globally through a number of legal entities and branches in circumstances where it would have been extremely difficult, if not impossible, to separate out the assets and affairs of the separate entities. In, *In Re Bank of Credit & Commerce International (Overseas) Ltd, Credit & Fin Corp Ltd and International Credit and Inv Co (Overseas) Ltd,*[33] the Grand Court therefore exercised its discretion under the Companies Act to approve a pooling arrangement agreed between the liquidators of the Cayman Islands bank, Bank of Credit & Commerce International (Overseas) Ltd, and an associated Luxembourg company, whereby assets recovered in the separate liquidations would be pooled and available for distribution to creditors globally on a *pro rata* basis.

- The schemes of arrangement referred to in the well-known *SPhinX*[34] cases are also examples of asset and liability-pooling in a manner similar to that described above. *SPhinX* concerned a liquidation of 22 group companies in circumstances where the official liquidators had concluded that the group members' assets and liabilities were hopelessly intermingled and that a vast number of legal and factual issues prevented a timely distribution of assets to investors. A scheme of arrangement was proposed, and eventually sanctioned and subsequently amended pursuant to which provision was made for, among other things, the pooling of the assets and liabilities of the group companies and the process for the determination of claims against the combined estate.

- In the case of *In the matter of Trade and Commerce Bank (in Official Liquidation) and others,*[35] the Grand Court consolidated the funds of a group of companies so that, whilst claims would continue to require to be filed against the separate estates of each company, distributions to creditors would be paid from a pooled account comprised of the combined assets of each of the companies. The Grand Court made such an order in circumstances where the evidence in support of the

[33] *In Re Bank of Credit & Commerce International (Overseas) Ltd, Credit & Fin Corp Ltd and International Credit and Inv Co (Overseas) Ltd*, Grand Court, unreported, Harre J, 19 June 1992.

[34] *In the matter of the SPhinX Group of Companies (in official liquidation)*, Cause No FSD 16 of 2009 (ASCJ).

[35] *In the matter of Trade and Commerce Bank (in official liquidation) and others*, Grand Court, unreported, 6 June 2003, Cause Nos 496, 555, 756, 757 and 758 of 2002 (ASCJ).

application narrated that the interrelationships between the group companies, the manner in which the affairs of the group companies had been conducted and the inadequacy of records, among other things, made it difficult for the liquidators to determine conclusively which funds rightfully belonged to which company in liquidation and which amounts were due from one to the other as a result of acts and omissions in relation to transactions which had or should have taken place between them.

5.3 Role of creditors and creditors' committees in a substantive consolidation

As noted above, where interlinked schemes of arrangement are proposed in respect of a number of group companies, the failure of the creditors to approve any one scheme of arrangement in respect of any one group company would, depending upon how the schemes of arrangement are structured, very likely render all other proposed interlinked schemes of arrangement ineffective.

Also, in such circumstances, creditors would not vote on a group-wide consolidated basis and therefore, while voting may take place at the same place and time, strictly, creditors would vote separately on each scheme of arrangement proposed by each individual group company.

For the purpose of voting on schemes of arrangement, creditors are divided into classes, the constitution of which would be proposed by the company and considered and fixed by the Grand Court. The traditional formulation of the test for the constitution of voting classes for schemes of arrangement is that each class must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest.[36] Accordingly, creditors who hold different rights and entitlements in respect of the company, or which are treated differently by the proposed scheme of arrangement, may fall into separate classes for voting purposes.

5.4 Voting for or against a substantive consolidation

A general principle exists that creditors who are not affected by the terms of a scheme of arrangement are not required to be a party to it or to vote on it. Determining whether creditors are affected by the proposed scheme of arrangement involves determining whether such creditors' rights and / or interests against the debtor company are affected by it.

In circumstances where there are creditors who have no economic interest in the debtor company (being those creditors who are "out of the money"), it may be possible to propose a scheme of arrangement that transfers the assets of the company to a new corporate structure in which the creditors who *do* have an economic interest in the debtor company have new interests, thereby leaving the "out of the money" creditors behind, with unaffected claims against a shell company with no assets to satisfy such claims. In such circumstances, the "out of the money" creditors may not be party to, and may not therefore vote on, the proposed scheme of arrangement if it can be shown that they have no economic interest in the assets. However, such analysis is extremely fact-specific. In many cases, determination of whether a creditor or class of creditors holds an economic interest is made by

[36] Per Bowen LJ in *Sovereign Life Assurance Co v Dodd* [1892] 2 QB 573.

reference to what the creditors are likely to receive in a liquidation of the debtor and, as such, valuations and liquidation analysis are often crucial.

Generally, secured creditors are likely to form a separate class to unsecured creditors for the purposes of voting in respect of a scheme of arrangement. In addition, where creditors benefit from security over assets, it will not likely be possible to release the security without including the secured creditors within the scheme of arrangement.

6. Equitable distribution and accountability of IPs

A restructuring of a company's liabilities in which creditors are "bailed in" by having their claims released in consideration for the issuance of equity or other rights or entitlements may be achieved under Cayman Islands law by way of scheme of arrangement proposed pursuant to section 86 of the Companies Act.

A Cayman Islands scheme of arrangement is a very flexible tool which can be used to implement a financial restructuring and, in circumstances where the proceeds of a total liquidation of the company's assets would be insufficient to pay all creditors in full, it is relatively common for some creditors to be issued with equity or equity-style instruments in exchange for a release of their claims as part of the compromise which is the subject of the scheme of arrangement.

There are no provisions of Cayman Islands law similar to the EU Bank Recovery and Resolution Directive[37] which provide for a mandatory bail-in of certain creditors of certain debtor entities by operation of law without a scheme of arrangement being sanctioned by the Grand Court.

7. Intercompany claims

7.1 Order of priority

In accordance with section 140(1) of the Companies Act, "the property of the company shall be applied in satisfaction of its liabilities *pari passu* and subject thereto shall be distributed amongst the members according to their rights and interests in the company."

However, section 140(2) of the Companies Act notes that the distribution of property as set out in subsection (1) is without prejudice to and after taking into account and giving effect to the rights of preferred and secured creditors and to any agreement between the company and any creditors that the claims of such creditors shall be subordinated or otherwise deferred to the claims of any other creditors and to any contractual rights of set-off or netting of claims between the company and any person or persons (including, without limitation, any bilateral or any multilateral set-off or netting arrangements between the company and any person or persons) and subject to any agreement between the company and any person or persons to waive or limit the same.

Accordingly, therefore, the claims of members of the company in their capacity as members would be subordinated to the claims of the creditors of the company and, once the creditors are paid, the property of the company would be distributed to the

[37] Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms.

members of the company in accordance with their rights and interests in the company.

Section 49(g) of the Companies Act further exemplifies this principle as it states that, when a company is being wound up, no sum due to any member of a company in his or her character of a member by way of dividends, profits or otherwise, shall be deemed to be a debt of the company, payable to such member in a case of competition between himself or herself and any other creditor not being a member of the company, but any such sum may be taken into account for the purpose of the final adjustment of the rights of contributories amongst themselves. Therefore, if the debt owed to the parent or affiliated company is in the form of dividends or profits due to it in its character as a member of the company, it would not be deemed a debt of the company and therefore would be subordinated to the claims of any creditors.

It is also a recognised principle in Cayman Islands corporate law that intra-group debt claims, such as a loan by a parent company to its subsidiary company, would not be subordinated and would therefore rank *pari passu* with ordinary unsecured creditor claims because, in such circumstances, the parent's claim would be in its capacity as a creditor of the company, and not in its character as a member of the company.[38]

For completeness, we note that there are certain circumstances in an investment funds context in which a former member may be a creditor of a company in circumstances where the former member has redeemed shares in the company but has not received payment of its redemption proceeds. Section 37(7) of the Companies Act addresses this scenario and includes certain provisions regarding subordination of such "redemption creditor" claims behind ordinary unsecured third-party creditors. Following a decision of the Privy Council concerning the *Herald Fund* SPC official liquidation,[39] the position is that members who have redeemed shares prior to the commencement of the liquidation but who have not been paid their due redemption payment are deferred creditors of the debtor and therefore rank after the claims of "ordinary" unsecured third-party creditors but ahead of the claims of continuing members of the debtor who had not redeemed their shares.

7.2 Concepts that can alter priority

The concepts of "recharacterisation" of intercompany debt as equity or "equitable subordination" are not specifically provided for in Cayman Islands law. However, the commercial terms of, for example, a scheme of arrangement may give effect to recharacterisation of debt as equity in the context of a debt-for-equity swap: the terms of the debt-for equity swap would be set out in the scheme document itself and would require the approvals referred to above, in relation to schemes of arrangement, as well as the sanction of the Grand Court.

8. Administering a complex estate in one single consolidated procedure

The concept of the "enterprise group" is not a feature of Cayman Islands statute.

[38] A point supported by the reasoning of Kay J in *Re Dale and Plant Ltd* (1889) 43 Ch D 255, a case which would be persuasive in the Cayman Islands.

[39] Michael Pearson (in his capacity as additional liquidator of *Herald Fund SPC (in official liquidation) v Primeo Fund (in official liquidation)* [2017] UKPC 19).

9. Handling an insolvent parent with a healthy subsidiary

The Cayman Islands courts adhere to the common law doctrine that each company has its own distinct legal personality and are very reluctant to pierce the corporate veil. Accordingly, it is highly unlikely that solvent subsidiaries would be consolidated within an insolvent group proceeding.

Although there is no statutory legal framework in the Cayman Islands for substantive consolidation of assets and liabilities within an insolvent group, as noted above there are limited examples where asset and liability-pooling arrangements have been put in place.

FRANCE

1. Consolidated group restructurings versus cooperation or coordination procedure

Apart from exceptional cases that will be dealt with below, French Applicable Law[1] does not allow for "substantive consolidation" of group companies' assets and liabilities.

Procedurally, until the reform of 2015, known as the "Macron Law",[2] there were no specific provisions governing the treatment of corporate group restructurings. This was the consequence of the French legal principle of independence of companies.

In case of difficulties affecting a group of companies, in principle under French Applicable Law, courts were supposed to judge each entity of the group separately. As a result, each subsidiary remained subject to the jurisdiction of the court of the place of its registered office.

The only possibility for referring the case to another court came into effect "when the interests at stake so justified",[3] in the name of "good administration of justice" in the event of group restructuring. But the procedure was quite complex (and in practice in urgent situations too burdensome and long) since it required a decision of the Commercial Court *sua sponte* or upon request of the Public Prosecutor, and in each case the First President of the Court of Appeal having jurisdiction (or of the Supreme Court) would decide which court had the final jurisdiction.

Since the Macron Law, a new principle has emerged, namely "procedural reunification".[4] Essentially, according to article L 662-8 of the French Commercial Code, the court to which recourse is sought first has jurisdiction for a holding company or even for a subsidiary, as long as there are "sufficient capital links".

Whereas, in the past, such cases had to be referred to another court that had jurisdiction, now it is legal, and there is an "irrefutable presumption" that the same court shall assume jurisdiction and handle all proceedings jointly.

1.1 Corporate group versus individual legal entity

1.1.1 Insolvency and restructuring systems that are in force

Regarding insolvency procedures, the general rule applies as follows.

Each subsidiary, even a member of a group and controlled by a holding company, is its own separate legal entity. This implies that each individual company in a critical economic situation must request the opening of its own insolvency procedure at the court which has territorial jurisdiction and which therefore might be different for each subsidiary of the same group.

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1 French Applicable Law on restructuring and liquidation of companies is codified in Chapter 6 of the French Commercial Code. The text is the base reference of applicable law in this field. Being a civil law country, the French Commercial Code is of the utmost importance. "Case law" is not developed like in many Anglo-Saxon countries but the main decisions of the Supreme Court (Cour de cassation) and some important decisions of courts of appeal are integrated into the French Commercial Code under the main applicable article and are part of French Applicable Law.

2 Law No 2015-990, 6 August 2015.

3 French Commercial Code, former ART R.600-1.

4 Vallens, RTD com. 2015. 593 s. p. 595.

The principle of pluralism of competent jurisdiction has been justified by the French legislator because a group of companies, which has no legal personality *per se*, cannot request the opening of an insolvency procedure and, of course, the competent jurisdiction is therefore determined by the place where each individual company has its head office. Consequently, many courts might be competent with regard to a particular group.

The following measures are available, in order to avoid the issues emerging from pluralism of competent jurisdiction:

- substantive consolidation through "extension" of an insolvency procedure to other companies of the same group is allowed under a few conditions. The insolvency of one company may be extended to another company on the ground of "fictivity" or "commingling of estates".[5] Notably, a company can be deemed fictitious in the absence of an *affectio societatis*, where a principal acted in his or her own interests under the cover of the incorporation and in the absence of decision-making autonomy for the subsidiaries.

  The commingling of assets and liabilities requires a finding by the court – usually on the basis of the insolvency practitioner (IP) report – that there is a commingling of accounts resulting in an "abnormal financial stream" between the companies.[6]

  The abnormal financial stream must be recurring and may be established by the absence of consideration in the transaction. In the case of a group, the assessment of the existence of abnormal financial streams by French courts is strictly applied by the French Supreme Court;[7] and

- as described above, "procedural reunification" is now the rule according to article L 662-8 of the French Commercial Code.

In France, there are approximately 134 commercial courts. A commercial court has jurisdiction over an insolvency case if the debtor's corporate headquarters or its centre of main interests (COMI) is located in the court's geographical zone. This regime has been criticised, principally for two reasons: a small commercial court may not have the financial or human resources to handle large insolvency cases; and an affiliated group of companies may be subject to the jurisdiction of different commercial courts.

France has created a limited number of 18 specialised insolvency courts.[8] These specialised insolvency courts have jurisdiction over large cases and also have jurisdiction over the insolvency proceedings of the members of an affiliated group of companies, taking into consideration the companies that are directly or indirectly controlled or owned within the meaning of articles L 233-1 and L 233-3 of the French Commercial Code.[9]

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[5] French Commercial Code, art L 621-2.

[6] Cass. Comm. 19 April 2005 Metaleurop, Joly 2005 p. 690. For a report on case law regarding "extension", see Pérochon, *Entreprises en difficulté*, 9ème éd., LGDJ, 2012, No 327; A Lienhard, *Procédures collectives,* 4ème éd., Delmas, 2011, No 64.13.

[7] See examples of *Cour de Cassation* decisions on this topic under L 621-2, French Commercial Code.

[8] French Commercial Code, arts L 721-8, D 721-19.

[9] *Idem*, art L 233-1 provides that when a company owns more than 50% of another company's capital, the second company shall be regarded as a subsidiary of the first company. Art L 233-3 states that a company is deemed to control another company: (a) when it directly or indirectly holds a fraction of the capital which gives it a majority of the voting rights at that company's general meetings; (b) when it alone holds a majority of the voting rights in that company by virtue of an agreement entered into

Thus, when insolvency proceedings have been opened against a subsidiary that does not individually meet the thresholds described below, and subsequent insolvency proceedings are opened at the level of a parent company that directly or indirectly controls or owns such a subsidiary, the proceedings of the subsidiary will be automatically transferred to the specialised commercial court which has jurisdiction over the parent company.

This new regime avoids inconsistencies or conflicts in court rulings and will increase efficiency and predictability in large restructuring cases. The provisions of the Macron Law governing specialised insolvency courts came into effect on 1 March 2016.

A specialised insolvency court will have jurisdiction over the debtor in safeguard, reorganisation and liquidation proceedings where the debtor has:

- 250 or more employees and turnover of at least EUR 20 million;
- the debtor has turnover of at least EUR 40 million;
- the debtor is a holding company that, together with its operating subsidiaries, has more than 250 employees and turnover exceeding EUR 20 million; or
- or the debtor is a holding company that, together with its operating subsidiaries, has turnover exceeding EUR 40 million.

Requested by the company, by the Public Prosecutor or by the court's President, a specialised insolvency court may also have jurisdiction in a conciliation proceeding when the debtor meets the foregoing criteria.

Finally, a specialised insolvency court will have jurisdiction over the debtor when the insolvency proceeding is commenced under the EIR Recast and the debtor's COMI is located in the court's geographical zone.

1.1.2 Definition of a corporate group

Under French Applicable Law, the concept of a group of companies has more of an economic substance than a legal content. Thus, a group of companies is made up of subsidiaries controlled by a holding company.

Article L 233-3-I of the French Commercial Code is comprehensive regarding the notion of "control", which might be direct or indirect (discussed in further detail below).

Despite the holding's control over its subsidiaries, companies integrated into a group are legally independent.

However, this theoretical legal independence does not match up with the legal and operational control usually exercised by the parent company over its subsidiaries and

with other shareholders and this is not contrary to the company's interests; (c) when it determines in fact, through the voting rights it holds, the decisions at that company's general meetings; or (d) when it is a shareholder of that company and has the power to appoint or dismiss the majority of that company's governing bodies. Further, a company is presumed to exercise control when it directly or indirectly holds a fraction of the voting rights which is higher than 40% and no other person holds a fraction larger than its own.

the common interests they hold.

The main definition of a corporate group in the restructuring field results from article 2(13) of Regulation (EU) 2015/848 on insolvency proceedings (EIR Recast), defining the group as a parent undertaking with all its subsidiaries. The parent company, according to article 2(14) of the EIR Recast, is defined broadly so as to encompass all sorts of groups. The level of integration of the group is described within Appendix 53 of the EIR Recast. According to this distinction, it appears that fully integrated groups could benefit from the main proceedings for all its companies coming before the same court and with the same applicable law if the COMI of all the companies is in one country. On the other hand, if the group is not fully integrated then the cooperation system developed in Chapter V of the EIR Recast applies.

1.1.3 Legislation relating to corporate groups

The legislation dealing with "corporate groups" is set out above.

1.2 Corporate group versus individual corporate benefit

1.2.1 The existence and relevance of "corporate group benefits"

In 1985, *Rozenblum,*[10] a tort law case, created the concept of the "group's best interest", mitigating the absolute priority of the individual company's interest, which is still the ordinary principle.

According to this case, all of the following conditions have to be met to validate a transaction within the group – otherwise, the management would be indicted for misuse of company property because of financial assistance between companies within the same group:

- the group must demonstrate financial and legal links between companies of the same group and also a common strategy to reach a common goal;

- a transaction shall only be implemented if an economic, financial or social common interest shall benefit the whole group; and

- financial assistance must be at arm's length and shall never exceed the financial capacity of the borrower.

Nevertheless, the group's best interest does not exist legally in insolvency procedures and tax laws, and a transaction in accordance with the group's best interest might still be described as an irregular management action.

Lastly, in French law, despite its acknowledgement in the *Rozenblum* case, the group's best interest is considered less significant than the company's best interest.

1.2.2 Director liability

Since the reforms of 1985,[11] the French system is focused on the restructuring of entities that can be saved. Thus, the system being a debtor-led proceeding, directors

[10] Cass. Crim. 4 February 1985, Droit pénal des affaires, Précis Dalloz, Wilfrid Jeandidier & Xavier Pin.
[11] Law of 25 January 1985 *sur le redressement des entreprises*.

and officers are less subject to liability for continuing the business after filing, unlike in Germany, for instance.

Nevertheless, unlike in the United States, the law still contains provisions regarding the civil liability of directors for not filing a company after 45 days of its illiquidity: that is, when the company cannot pay its matured debts when they fall due.[12]

The liability of directors can also still be recognised when a fraudulent transfer, contrary to the interest of the company, to another company in the group has taken place when the criteria mentioned above in the *Rozenblum* case are not met.[13]

1.2.3 "Early warning systems"

The authors are not aware of any specific regulation on this topic. Indirectly, the parent company has to be informed as is the case for any other shareholder. The parent company could also be at risk, particularly if it has a social mandate within the subsidiary and is aware of the subsidiary's difficulties without taking any action.

Directors have an obligation to convene an extraordinary general shareholders' meeting when the equity has dropped below half of the share capital. This also applies to a parent company if the parent company has a social mandate in the subsidiary.[14]

1.2.4 Pending or draft legislation

There is no specific legislation being considered / pending to deal with these issues.

1.3 Universalism versus territorial principle

1.3.1 Application of the modified universalism rules

The EIR Recast applies in France for European Union (EU) corporate groups whether it concerns main or secondary proceedings. The regulation applies to all proceedings listed in Annex A.

A slight amendment to the preventive restructuring tools (*mandat ad hoc* and *conciliation*), the nature of which is explained further below, will be necessary to make these procedures collective proceedings in accordance with the EIR Recast.

This regulation is still unclear when groups have subsidiaries both in the EU and outside the EU because France has not adopted the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency. The enforcement of inbound foreign insolvency judgments from outside the EU still has to be through an "exequatur"[15] procedure before the competent court in France to seek recognition and enforcement.

[12] French Civil Code, art 1382; together with French Commercial Code, art L 651-2, para 1.
[13] French Commercial Code, art L 241-34.
[14] *Idem*, arts L 223-42, L 225-248.
[15] Cass. Civ. 28 March 2012 No 11-10639 application of art 509, Civil Proceedings Code with respect to the exequatur of foreign insolvency judgments.

1.3.2 Bilateral and / or multilateral treaties in force

The applicable framework is the EIR Recast, as discussed above.

1.3.3 Pending legislation

There is no pending legislation on these issues.

1.4 Competent court and applicable law

The French definition of COMI is clearly inspired by Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings (EIR) and the EIR Recast. Macron Law No 2015-990 of 6 August 2015 gives competence to specialised courts when the COMI is located in France.[16]

1.4.1 Applicable law that falls outside of the lex fori concursus and related issues

According to the EIR Recast, the *lex fori concursus* applies by principle to the whole proceeding. According to certain authors, some disputes could still arise regarding some contracts depending on a specific law. For instance, if some financial contracts give specific jurisdiction and reference to a specific applicable law for the analysis of some concepts absent in the *lex fori concursus*, the judge will necessarily have to refer to the concepts of the specific law.[17]

1.4.2 Harmonisation of substantive restructuring and insolvency laws

"Modified universalism" as it applies in France due to the EIR and the EIR Recast appears to follow the direction the EU legislator envisaged when dealing with corporate group insolvencies. Similar to *Collins & Aikmans* in the United Kingdom,[18] European courts seem more and more open to the universalistic approach as soon as corporate group insolvencies are brought before their jurisdiction. This modified universalistic approach, while using protocols, seems a more efficient way of handling group restructurings.

Nevertheless, a substantive approach appears necessary to avoid forum shopping and to deal with drawbacks encountered in big restructuring cases like Lehman Brothers.[19] The proposition for an EU Directive on preventive restructuring and second chance mentioned below is a clear attempt to introduce some substantive bases into the restructuring field.

A specific approach concerning corporate groups, going further than current guidelines and the proposals of UNCITRAL Working Group V, would be welcomed but will face many public policy exceptions particularly when it comes to the notion of groups.

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[16] French Commercial Code, art L721-8,.

[17] *JL Vallens, le créancier et le règlement communautaire*, 2.

[18] *Re Collins & Aikman Europe SA* [2006] EWHC 1343 (Ch).

[19] *Lehman and Dante CDO case*, described by A V Sexton, "Current Problems and Trends in the Administration of Transnational Insolvencies Involving Enterprise Groups: The Mixed Record of Protocols, the UNCITRAL Model Insolvency Law, and the EU Insolvency Regulation" (2012) 12(2) *Chicago Journal of International Law*.

1.4.3 *Applicable treaties and case law*

See the comments above in relation to enforceability through "exequatur" for inbound cases, as well as the comments on the EIR and the EIR Recast.

2. Substantive consolidated restructuring proceedings versus synthetic group restructurings

In line with the EU Draft Directive on preventive restructurings and second chance,[20] France has nearly 34 years of experience on preventive restructurings. The two schemes in France, which were created in 1984 and are lightly supervised by the courts, are *mandat ad hoc* and *conciliation*.[21] These soft proceedings allow the management and the stakeholders of the company to be assisted by an independent third party appointed by the President of the court, usually a Judicial Administrator, in order to negotiate an agreement between the company and all stakeholders (banks, bondholders, fiscal and social organisations and others).

Such a procedure, requested by management, usually aims for the prevention of the opening of an insolvency procedure, considering benefits such as: confidentiality (there is no legal advertising); the possibility of ending the procedure under control of management at any time; a fast implementation of the procedure; and the appointment of a Judicial Administrator within 48 hours of the request. In addition, a benefit for small and medium-sized enterprises is that these proceedings have a high level of success due to the climate of trust and confidence established by the Judicial Administrator. The Judicial Administrator's fees are decided by the court's presiding judge, according to a scale set by practice and with the management's consent. The request must be filed in writing and must explain the difficulties encountered by the company. If the request is accepted, an *ad hoc* agent or a conciliator is appointed by the Presiding Judge's order. The company's management is allowed to suggest a Judicial Administrator. The mission's scope, duration and fees are stated in the order with the management's consent.

What makes the proceeding a potential synthetic proceeding, including for international corporate groups, is its softness and the ability of the appointed "*mandataire ad hoc*" or "*conciliateur*" to discuss the situation and the plan to be implemented with all the stakeholders. For instance, the valuation of assets that is necessary to determine "in and out of the money" creditors can be launched without the opening of a formal "free fall" proceeding. This valuation is non-binding but is usually accepted by most creditors to set up an agreed re-evaluation of the balance sheet.

During these discussions and reassessment of the situation by an independent third party proposed by the *mandataire ad hoc* to the stakeholders, in practice creditors allow the financing of this phase through a "London approach" standstill agreement. Instalments are frozen and credits maintained in order to keep the business going until the presentation of the independent business review by the *mandataire ad hoc* to the stakeholders.[22]

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[20] EU Commission Proposal 2016/0359 (COD) for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU.

[21] French Commercial Code, arts L611-3, R611-18 for "mandat ad hoc" and arts L611-4, R611-22 for "conciliation".

[22] For an analysis of the interest of these proceedings as an entry route for cross-border cases, see R

Besides the above-mentioned agreement procedures, French law provides for judicial procedures (debtor protection). One of them, called the "*sauvegarde*" (or safeguard), might be requested by the management when payments have not yet been suspended. *Sauvegarde* should be considered as a preventive and proactive procedure: the debtor places him or herself under the judicial protection before becoming insolvent.

Since 2010, the French legislator has created two versions beside the usual *sauvegarde*:

- Law of 22 October 2010: the Rapid Financial Safeguard; and

- Decree of 12 March 2014: the Rapid Safeguard.

Those procedures are inspired by the American "pre-pack" and have been used by legal practitioners in a few cases. They are more useful because of the threat of cram down they represent for dissenting creditors during amicable discussions.

These are alternatives to the common *sauvegarde*: the same provisions are enforceable, under a few conditions.

Their purpose is to pre-negotiate an agreement approved by most of the creditors during a Court Lightly Supervised Proceeding, in order to have this agreement endorsed as a plan voted by investors and bankers within the month following the conversion of the first procedure into an Accelerated Sauvegarde.

Those procedures have two essential characteristics: they are financial procedures (the objective is to quickly adopt the plan pre-negotiated during the Court Lightly Supervised Proceeding), and they are rapid procedures (the usual periods are shortened).

The Rapid Financial Safeguard / Rapid Safeguard are recent, efficient tools with regard to companies' rescue procedures because they implement a new approach where creditors are invited to take part in the rescue of the company's value, and creditors are separated into classes for the vote on the plan. They are useful because they may compel some creditors who are not willing to enter into an agreement approved by the majority.

Both procedures are covered by the EIR Recast.

International groups might benefit from the provisions and opportunities offered by these preventive restructurings and then prepare the exit through any restructuring tool available.

3. Duty to initiate insolvency process

There is a process for undertakings to be provided by a foreign IP in a EU Member State under article 36 of the EIR Recast, as implemented in article 692 of the French Commercial Code. However, this would need to be adopted for each entity within a

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Dammann, and G Podeur, Revue Lamy Droit des affaires, No 10, 1 November 2006 and No 16, 1 May 2007.

corporate group as a separate entity as there is no provision for a consolidated group guarantee to be provided.

There is also no specific guarantee procedure for IPs in non-EU Member States. Any guarantee provided would need to contend with the fact that the obligation for directors to file within 45 days of insolvency is still applicable In France.

4. Legal certainty and predictability

Apart from the protections in article 36 of the EIR Recast, as implemented by article 692 of the French Commercial Code (which include the need for an undertaking to be approved by known local creditors) – for each single entity within a group – for guarantees provided by an IP in a non-EU Member State, the solution would also have to be agreed with the main creditors, who would retain the ability to enforce their rights.

5. Consolidation of assets

5.1 Procedure with respect to the sale of the whole or part of a business

There are two ways to deal with the sale of assets.

The first is to go through a restructuring plan and obtain creditors' votes on the plan for each individual company. In this case, the three creditors' committees (i.e. suppliers, financials and bondholders) have to agree with a majority of 75% of voters in each committee. All the shareholders have to also agree on the plan, after which the court can enforce the plan.

The second way rests with the discretionary power of the court which can decide that a continuity plan is not feasible. In this case, the court may decide on the sale of business or of the assets without consent of the creditors. The main criteria the court has to apply are: the credibility of the offer; the number of jobs saved; and the price offered. This scenario allows for the defeat of the position of shareholders who are blocking the process. No majority is necessary in this case: the court is the only decision-maker.

5.2 Difference in treatment with respect to tangible and intangible assets

The procedure is the same for tangible and intangible assets. The sale price must clearly indicate which part of the price is the responsibility of tangible assets and which part of the price is due to intangible assets.

5.3 Role of the creditors and the creditors' committees in a substantive consolidation

In the event that some creditors oppose a plan comprising substantive consolidation, a formal proceeding would have to be opened in order to implement it after the voting process described above.

5.4 Voting for or against a substantive consolidation

According to current legislation and the functioning of committees, some creditors or shareholders would have the ability to vote down such a plan. They could only be forced to accept a substantive consolidation plan under the condition of majority described above or bypassed by the court in an order implementing a global sale of assets.

6. Equitable distribution and accountability of IPs

The conditions of majority described above would have to apply. Otherwise, the court could decide without any consent of the creditors to order a sale and the proceeds would be distributed by the IP according to the rank of the creditors.

7. Intercompany claims

7.1 Order of priority

In France, intercompany claims rank *pari passu* if no specific subordination has been accepted nor any privilege claim accepted. Nevertheless, for the purpose of a continuity plan, in practice in most restructurings, intercompany claims are subordinated to other claims.

7.2 Concepts that can alter priority

Various legal mechanisms are possible to transform a debt into equity (such as capital increase with incorporation of debt and bonds convertible into shares).

8. Administering a complex estate in one single consolidated procedure

The complexity of a corporate group can in general be overcome by the restructuring plan endorsed by the court.

9. Handling an insolvent parent with a healthy subsidiary

A solvent subsidiary cannot enter into a formal restructuring proceeding but could enter a preventive restructuring proceeding or a safeguard procedure as soon as financial difficulties arise, which is a classic problem when the parent company is insolvent. This would allow the best possible outcome for the whole group.

In order to consolidate the subsidiaries with the parent, an “extension” to the initial proceeding could be launched, but only if the parent is in France. Otherwise, depending on the location of the parent, the proceeding would have to be recognised, but the public policy exception could impair the foreign decision if the French subsidiaries are solvent.

GERMANY

1. Consolidated group restructurings versus cooperation or coordination procedure

Until 31 December 2020, German law did not provide for either out-of-court or in-court restructuring proceedings. Where the necessary consent to an out-of-court restructuring could not be obtained from the parties involved, there was in principle no alternative to formal in-court insolvency proceedings in Germany as a basis for a restructuring.

However, on 1 January 2021, the bill for the further development of the German restructuring and insolvency law (the German Scheme or StaRUG) came into effect in Germany. It is based on the Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency). Its centrepiece is a newly introduced pre-insolvency restructuring scheme which allows for the implementation of a restructuring by means of a restructuring plan subject to majority decisions outside of formal insolvency proceedings.

However, both the German insolvency proceeding and the StaRUG do not provide for consolidated group restructuring proceedings but rather comprise certain tools by means of which, for example, third-party collateral can be released under certain prerequisites.

- **Insolvency proceedings**

  German insolvency proceedings follow a single entity concept. In purely domestic situations, when more than one affiliated company is subject to formal insolvency proceedings, there is no statutory concept which would enable the competent insolvency court(s) or insolvency practitioner(s) to consolidate the proceedings. This means that each insolvent debtor's assets, debts and costs arising in connection with potential insolvency proceedings have to be considered separately even where multiple insolvent entities belong to the same group of companies.

  On 13 April 2017, the German Parliament enacted an amendment to the German insolvency law to enable the simplified treatment of group insolvencies (*Gesetz zur Erleichterung der Bewältigung von Konzerninsolvenzen*), which was incorporated into the German Insolvency Code (*Insolvenzordnung*) (InsO) and came into effect on 21 April 2018. The InsO predominantly aims at achieving better coordination between the insolvency proceedings commenced for group companies.

  In cases where companies that form part of the same group have their centre of main interests (COMI) in Germany, the InsO provides for certain tools to facilitate the administration and restructuring in order to ensure that the administration is in the best interest of the creditors, as follows:

  Group jurisdiction

  In the past, in situations where affiliated group companies were located in different places, companies and their advisors had to argue and justify that all group companies had the same COMI to achieve the result that only one local court would have jurisdiction for the opening of insolvency proceedings in respect of each of the insolvent group companies and that only this court would supervise and run the insolvency proceedings. For instance, this was argued in the insolvency of the PIN group, a Luxembourg-based group which focused its business on postal services and had regionally active subsidiaries all across Germany. Nevertheless, insolvency proceedings for numerous group members were opened at the local court of Cologne, where a company which controlled the subsidiaries and conducted central services had its COMI.[1]

The InsO now provides for the possibility of an insolvency court assuming group jurisdiction. Where a group company files for the opening of insolvency proceedings, the seized insolvency court may – upon application by the company and under certain further circumstances – declare itself competent also with respect to subsequent insolvency proceedings for companies that also form part of the same group but with their COMI in different courts' districts.[2] Such jurisdiction qualifies as additional jurisdiction of choice and does not constitute a sole jurisdiction for other group companies. The concentration would also have an effect at judicial level, so that the judge / judicial officer who is competent at the court of the group jurisdiction would also be competent with respect to subsequent proceedings of related group companies.[3] If a group jurisdiction is not established, the insolvency courts have to cooperate.[4]

Group insolvency administrator

In cases where insolvency proceedings have been commenced for multiple group companies, having as few different insolvency administrators as possible would facilitate communication, sharing of information and efficiency of matters, decrease the administrative burden and also reduce the costs of the proceedings. Although even in these circumstances, an insolvency administrator would still be obliged to treat each company separately and to act in the best interests of each company's creditors, the insolvency administrator would be allowed to consider the interdependencies between group companies and to try to restructure or to sell the group's business in its entirety (which in many cases may result in a better outcome for creditors). In the past, to cause the same insolvency administrator to be appointed for more than just one group company, applicants had to establish that, in the absence of the appointment, it would be impossible to efficiently run the processes. The InsO now explicitly stipulates this approach.[5] However, courts are not obliged to appoint one and the same administrator for each group company. The selection of the (preliminary) administrator is in principle at the sole discretion of the court. However, even if no group administrator is appointed, the new law provides for far-reaching information and cooperation obligations owed by and between the various insolvency administrators of affiliated group companies.[6] This may include protocols in which the insolvency administrators establish and clarify cooperation and communication duties in a legally binding way.[7]

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1 See AG Köln – 73 IN 682/07.
2 InsO, ss 3a-3d.
3 *Idem*, s 3c.
4 *Idem*, s 269b.
5 *Idem*, s 56b para 1.
6 *Idem*, s 269a.
7 *Idem*, s 269 para 2 no 3.

Coordination proceedings

The InsO now also provides for so-called coordination proceedings.[8] The core element of such proceedings is the appointment of a group coordinator and a cooperation plan. Upon application, coordination proceedings can be opened by the group court. Such proceedings are designed to facilitate coordination of the multiple insolvency proceedings within a group of companies. An independent third party must be appointed as coordinator and must act in the interests of all group companies' creditors.[9] In particular, where no group insolvency administrator is appointed, the group coordinator shall act as mediator and arbitrate between officeholders appointed in the multiple insolvency proceedings over group companies. In order to achieve the best possible coordination of proceedings, the coordinator appointed can devise a coordination plan.[10]

In practice, very often insolvency proceedings for sizeable groups of companies are conducted as debtor-in-possession proceedings. Under the German concept of debtor-in-possession, the debtor's management retains its administrative and disposal powers but is supervised by a court-appointed custodian. While, empirically, debtor-in-possession is still applied for and granted in exceptional cases, in sizeable insolvency proceedings for group companies it is almost the rule. Consequently, the InsO also applies to insolvency proceedings conducted in the status of debtor-in-possession.[11] The main reason for using debtor-in-possession for group insolvency proceedings is that it helps to maintain the integration of and cohesion between the various group companies that are often mutually dependent on each other and regularly contractually connected. This is achieved by keeping incumbent management in place at the various group levels. In the absence of debtor-in-possession, due to lack of expertise and knowledge of the group, it would be almost impossible for one or more insolvency administrators to continue the business as before. The bigger the group is, the more important it is to obtain the status of debtor-in-possession.

If a group of companies only consists of individual companies having their COMI in Germany, the InsO applies. However, in cross-border cases, the European Insolvency Regulation (EIR Recast)[12] must be observed. With respect to cross-border issues within the European Union (EU), the EIR Recast takes absolute priority of application and overrules national law. The EIR Recast implements a similar framework for insolvency proceedings of members of a group of companies, insofar as it also provides for cooperation and communication duties as well as a group coordination proceeding.[13] These rules apply if proceedings relating to different members of the same group of companies have been opened in more than one Member State.[14]

However, in cases where the EIR Recast is not applicable as the issue is about a non-EU Member State, from a German perspective the German international insolvency law is applicable.[15] According to German international insolvency law,

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8 *Idem*, s 269d–i InsO.
9 *Idem*, s 269e/f para 1.
10 *Idem*, s 269h.
11 *Idem*, s 270d.
12 Council Regulation (EC) No 1015/848 of 20 May 2015.
13 EIR Recast, art 56 *et seq.*
14 *Idem*, recital 62.
15 InsO, s 335 *et seq.*

insolvency proceedings and their legal effects are subject to the law of the country in which the proceedings have been opened (unless otherwise specified in section 335 *et. seq* of the InsO).

There are no written rules for coordination with the insolvency proceedings of other members of a group when these proceedings are opened in a third state.[16] Cooperation and coordination with the insolvency proceedings in a third state are possible if the proceeding is recognised under German international insolvency law. Foreign insolvency proceedings are recognised if the courts of the state of the opening of proceedings have jurisdiction in accordance with German law (i.e. the COMI is in the respective state).[17] Furthermore, the recognition must not lead to a result which is manifestly incompatible with major principles of German public policy laws. If the proceeding is recognised, the objective of best possible satisfaction of creditors may constitute a duty on the insolvency administrator to coordinate with the foreign administrator, but also limits the insolvency administrator's actions.

- **German Scheme**

The German Scheme is available to debtors who have their COMI in Germany. It does not provide for a single holistic procedure but rather a flexible framework comprising a toolkit from which the debtor can choose to implement the restructuring. It can be applied to single entities but also to multiple entities. However, it does not provide for a consolidated proceeding covering a group of companies. Just as in cases of insolvency proceedings (see above), it provides for the possibility of the restructuring court assuming group jurisdiction under certain prerequisites.

The use of the tools provided by the German Scheme requires a notification of the debtor to the restructuring court, in particular including: (i) a restructuring concept; and (ii) a confirmation that the company is imminently cash-flow insolvent (but not yet cash-flow insolvent and / or over-indebted, which would constitute mandatory triggers for the initiation of formal insolvency proceedings).

Imminent cash-flow insolvency is considered a low bar as it can be assumed if it is more likely than not (greater than 50%) that the debtor will not be in a position to meet its payment obligations when those become due during a forecast period of 24 months. Should the debtor become insolvent after the initiation of the scheme process, the restructuring court must decide on whether the scheme process may be continued or, instead, the restructuring may only be further pursued in formal insolvency (plan) proceedings. This mainly depends on the level of progress accomplished so far in the restructuring process.

The German Scheme is designed as a debtor-in-possession process. The management remains in charge of the company's affairs. Only the debtor (through its management) is entitled to propose the restructuring plan and submit it to relevant creditors / affected stakeholders for adoption. Creditors are not entitled to initiate a formal German Scheme process.

[16] In this case, art 56 *et seq.* of the EIR Recast applies.
[17] InsO, s 343.

The restructuring plan allows for a comprehensive restructuring and recapitalisation of the debtor. It can comprise all of the debtor's secured, unsecured debts and collateral granted by the debtor and / or its affiliates. The plan further allows amending certain provisions in multilateral financing agreements, such as syndicated facilities agreements and also financing agreements concluded separately on the same terms with multiple persons (for example, promissory notes or bonds). In addition, related finance documents, such as security trust agreements and inter-creditor agreements, may be re-arranged.

The German Scheme also provides for the option to implement debt to equity swaps and other corporate law measures within the plan. Any change of control rights triggered by any such measure are deemed invalid by operation of law. The plan offers a high degree of flexibility as to its commercial content and the debtor is generally free to choose who shall be included in the plan. Hence, it is possible to include in the plan financial creditors only. However, in particular, employment and pension obligations cannot be structured by means of the restructuring plan. This remains only viable as part of a comprehensive in-court insolvency proceeding.

1.1 Corporate group versus individual legal entity

1.1.1 The insolvency and restructuring systems that are in force

As described above, German law does not recognise the concept of consolidated group insolvency proceedings. Instead, in the context of German insolvency law as well as restructuring on the basis of the German Scheme, each company is treated as distinct from its shareholders, partners or affiliates. This applies to limited liability companies as well as partnerships. Even where companies are controlled by the same owner, the question of which law is applicable is determined separately for each single company.

1.1.2 Definition of a corporate group

Legal "group" concepts are used in German law in particular in the context of its Stock Corporation Act (*Aktiengesetz*, or AktG)[18] and its Commercial Act (*Handelsgesetzbuch*, or HGB),[19] with the latter being relevant for the purposes of accounting and the preparation of financial statements. In most cases, the legal group concept under the AktG is used by reference to the definitions of "controlling company", "controlled company" and "affiliated company" within the meaning of section 15. AktG and often incorporated into contracts to provide a definition of a "corporate group".

Further, the InsO has introduced a legal group concept based on "control".

According to the InsO, a group comprises of at least two independent companies that: (i) have their COMI in Germany; and (ii) are directly or indirectly affiliated with each other by being subject to unified control or by being subject to the control of an affiliate.[20]

[18] AktG, s 15.
[19] HGB, s 271 para 2.
[20] InsO, s 3e.

The existence of a group within the meaning of section 3e of the InsO is a prerequisite for an insolvency court to assume group jurisdiction (discussed above) with respect to insolvency proceedings over affiliated companies. Also, the provisions on coordination and concentration, as well as the group coordination proceeding, only apply to groups within the meaning of section 3e of the InsO.

A similar definition is provided in the EIR Recast. Pursuant to article 2(13) of the EIR Recast, a group of companies is a parent undertaking and all its subsidiary undertakings. "Parent undertaking" is defined as an undertaking which controls, either directly or indirectly, one or more subsidiary undertakings.[21]

A similar concept is provided for under the German Scheme under § 36 of the StaRUG, which refers to the relevant sections under the German insolvency legislation.

1.1.3 Legislation relating to corporate groups

The relevant legislation is outlined above, and there are no other draft or pending laws.

1.2 Corporate group versus individual corporate benefit

1.2.1 The existence and relevance of "corporate group benefits"

German law does not provide for a corporate group benefit. In principle, the directors of a company are required to exercise the diligence expected of a prudent businessperson when conducting the affairs of the company and to act in the best interests of the company.[22] In principle, this duty is only owed to the company for which the director is appointed and does not extend to other companies within a corporate group.

However, when determining whether any measure is in the interests of a company, under certain circumstances the director may also take into consideration another group company's situation. For instance, it is generally assumed that if a parent company grants downstream security for the benefit of one of its subsidiaries, there is adequate corporate benefit to the parent company if the parent can be expected to obtain increased dividends or higher value of its shares in such a subsidiary. In the case of an upstream security, where a subsidiary provides security for the obligations of a parent or sister company, the subsidiary's benefit can be more difficult to argue, and its existence would depend on the circumstances of the individual case. For example, where a subsidiary grants security with respect to financing extended to a parent company of that subsidiary, the security is for the subsidiary's benefit if proceeds are being on-lent to it. However, the directors must ensure that, at the time of granting the guarantee, the right of indemnity against the parent company carries full value, and, furthermore, they are obliged to monitor the financial circumstances and development of the parent company and request further security in case of a deterioration of its financial position.[23] The assessment of whether a measure is in the best interests of the company is to be made in the individual case.

[21] EIR Recast, art 2 para 14.
[22] German Limited Liability Companies Act (GmbHG), s 43 para 1; AktG, s 93 para 1.
[23] See, for example, German Federal Court of Justice (BGH), judgment of 21 March 2017 – II ZR 93/16.

1.2.2 *Director liability*

As stated above, German law does not provide for corporate group benefit.

The directors owe their duties (i.e. their duty to act for the benefit of the company) only to the legal entity to which they are appointed. Directors can be held jointly and severally liable in the case of a breach duties that result in damage to the company.[24]

In cases where an individual serves as a director of several companies of the same group, for example as a director of the parent company as well as of the subsidiary, he or she has to consider only the interests of the company for which the director is making the decision (being the interests of the subsidiary if it is a decision of the board of directors of the subsidiary and the interests of the parent company if it is a decision of the board of directors of the parent company).[25] In case of ongoing contradictory interests, it might be necessary that the director resigns from the management board of one of the companies.

However, the shareholders of a German limited liability company (*Gesellschaft mit beschränkter Haftung*, or GmbH) may give instructions to its directors on the basis of a shareholders' resolution or when both entities have entered into a so-called domination (and profit and loss) agreement.[26] Such an agreement is often entered into by and between several entities within a corporate group for tax purposes (i.e. to create a fiscal unity scheme) and / or to allow for the directors of a controlling parent company to give instructions to its controlled subsidiaries without having to meet formal requirements such as shareholders' meetings. The loss / disadvantage incurred at level of the controlled subsidiary by any such instruction must, however, be compensated by the controlling parent company. Provided the director is validly instructed, it cannot be held liable for carrying out the instruction, even though the respective measure is not in the best interests of the company.[27] In principle, giving instructions on the basis of a shareholders' resolution does not bear the risk for a shareholder of being considered a *de facto* director unless the shareholder virtually takes over the management of the company and externally represents the company as a director.

1.2.3 *"Early warning systems"*

As stated above, the directors of a German company are required to exercise the diligence expected of a prudent businessperson in conducting the affairs of the company and to act in the best interests of the company.

This duty comprises the obligation to constantly monitor the financial condition and the economic state and development of the company, its parent and other affiliates as well as of any relevant counterparty. This is required for the directors to be in a position to react to changing circumstances that may affect or threaten the financial situation of the company to which they are appointed. For instance, when a company participates in intra-group cash pooling, the directors have to be in a position to make an assessment as to whether a potential repayment claim against its parent or affiliates carries value and, if not, assess whether any further action is required (such as the termination of the cash pooling or request for provision of security).

[24] GmbHG, s 43 para 2; AktG, s 93 para 2.
[25] German Federal Court of Justice (BGH), judgment of 9 March 2009 - II ZR 170/07
[26] GmbHG , s 37; AktG, s 308.
[27] AktG, s 310 para 3.

Where there is the threat of a financial crisis, the directors in particular should:

- prepare (and continuously monitor) the short-term and long-term liquidity status (in order to monitor illiquidity / cash-flow insolvency and the going-concern prognosis);

- implement a monitoring system to ensure that further financial risks (deterioration of the situation) can be identified at an early stage;

- consider all possible remedial steps and initiate such measures to the extent possible in order to ensure the viability of the company; and

- assess the probability of successful restructuring.

The directors are obliged to convene a shareholders' meeting if it appears to be necessary in the interests of the company (for example, if otherwise the company would suffer a significant disadvantage). Further, in the case where the directors have reason to believe that the registered share capital of the company has declined to 50% or less, they have to draw up an interim balance sheet immediately and convene an extraordinary shareholders' meeting without undue delay in order to inform the shareholders about the current situation, develop and discuss potential restructuring options to overcome the financial crisis or decide upon the filing for insolvency proceedings.[28]

1.2.4 *Pending or draft legislation*

There is currently no pending or draft legislation in relation to these issues.

1.3 Universalism versus territorial principle

1.3.1 *Application of the modified universalism rules*

German courts are bound by the European Insolvency Regulation (EIR)[29] and the EIR Recast, which supersede domestic law. German courts would therefore open ancillary insolvency proceedings on the basis of the EIR to the extent applicable. In terms of insolvency proceedings originating in non-EU Member States, the German courts would rely solely on German international insolvency law.[30]

Pursuant to section 335 of the InsO, the insolvency proceedings and their legal effects are subject to the law of the state in which the proceedings have been opened. If the COMI of a company is located in a non-EU Member State, section 354 of the InsO allows the opening of ancillary (territorial) insolvency proceedings over the company's assets which are situated in Germany. As under the EIR Recast, the option for territorial proceedings restricts the principle of universality to a substantial degree. If such proceedings are opened prior to the foreign main proceedings, they are known as isolated territorial proceedings. If they are opened after the foreign main proceedings, they are known as secondary insolvency proceedings.

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[28] GmbHG, s 49; AktG, s 92 para 1.

[29] Originally: Council Regulation (EC) No 1346/2000 of 29 May 2000; Currently applicable: Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings.

[30] InsO, s 335 et seq.

In contrast to the EIR Recast, which presupposes that an establishment exists in the state in which the territorial proceedings are to be opened,[31] under German international insolvency law even the mere existence of assets situated in Germany is sufficient to open territorial insolvency proceedings.[32] In addition to assets situated in Germany and the lack of competence with regard to the main insolvency proceedings, further prerequisites for the opening of territorial insolvency proceedings are the existence of sufficient assets in order to cover the cost of the insolvency proceedings and a request from a creditor to open territorial insolvency proceedings.

Once territorial insolvency proceedings are opened, all domestic assets no longer belong to the foreign assets involved in foreign main insolvency proceedings and the main insolvency administrator has no powers of management and disposition in this respect. However, the German insolvency administrator is obliged to cooperate with the foreign administrator who may also attend creditors' meetings and submit their own insolvency plan in the secondary proceedings.[33]

The Local Court of Cologne (AG Köln – 71 IN 1/04) ruled that it is even possible to conduct a secondary proceeding within the meaning of section 354 of the InsO as a debtor-in-possession proceeding. This meant that the right to manage and transfer the assets involved in the insolvency proceedings remained with the insolvency administrators of the main proceeding.

1.3.2 Bilateral and / or multilateral treaties in force

There are no applicable treaties.

1.3.3 Pending legislation

There is no pending legislation on any of these issues.

1.4 Competent court and applicable law

In cross-border insolvency cases, a German court only has jurisdiction for the opening of main insolvency proceedings provided that the debtor's COMI is in Germany. In principle, the question of which German court is competent depends on the court district in which the COMI of the relevant company is located.[34] However, as noted above, in the case of several group companies filing for insolvency, upon application and the fulfilment of the conditions pursuant to section 3a, paragraphs 1 and 2 of the InsO, the court seized also assumes group jurisdiction with respect to insolvency proceedings over those group companies whose COMIs are located in other German court districts.

In terms of the definition of COMI, the following applies: neither the EIR, the EIR Recast nor German insolvency law provide for an exhaustive definition of the term COMI. Pursuant to article 3, paragraph 1 subparagraph 1 of the EIR Recast, the COMI is the place where the debtor conducts the administration of its interests on a regular basis and which is ascertainable by third parties. In addition, article 3, paragraph 1, subparagraph 2 of the EIR Recast and section 3, paragraph 1 of the InsO provide for a

[31] EIR Recast, art 3 para 2.
[32] InsO, ss 354, 357.
[33] *Idem*, s 357.
[34] *Idem*, s 3 para 1.

rebuttable presumption that the place where the company's registered office is located is presumed to be its COMI, unless the registered office has been moved to another Member State within the three-month period prior to the request for the opening of insolvency proceedings.

The courts must take into account a number of factors when determining whether the presumption in favour of the registered office has been rebutted. These include, among others: the place where the company's business is managed and its contracts concluded; the place where board meetings are effectively held; the place where the accounts are prepared and audited; the location of customers, suppliers and creditors; the location of the majority of employees; and the country which governs their employment contracts. All these indications are, however, required to be ascertainable (i.e. objectively observable and verifiable) by third parties.

1.4.1 *Applicable law that falls outside of the lex fori concursus and related issues*

The EIR Recast sets out uniform rules on conflict of laws that supersede the domestic law of EU Member States. The EIR Recast does not, however, attempt to harmonise insolvency laws across the EU. According to the EIR Recast, the applicable insolvency law is that of the Member State within the territory of which such proceedings are opened (*lex fori concursus*); the *lex fori concursus* determines the effects of the insolvency proceedings on the persons and legal relations concerned and governs all the conditions for the opening, conducting and closing of the insolvency proceedings.[35] It is also the conflict of laws rules of the *lex fori concursus* that will determine the rules of the law governing a person's pre-insolvency entitlements (*lex causae*); the *lex causae* is then applied subject to those entitlements being modified or nullified by the *lex fori concursus*.

The EIR Recast does state certain categories of rights that are excluded from the *lex fori concursus*, including third parties' rights *in rem*, set-off and reservation of title.[36] The exclusions provided for under the EIR Recast are the same as those provided under German international insolvency law in section 335 *et seq*. of the InsO. If the choice of law is between the jurisdiction of law of a EU Member State and a non-EU Member State, the ordinary conflict of law rules and the German international insolvency law apply.[37]

1.4.2 *Harmonisation of substantive restructuring and insolvency laws*

It would be advantageous if the substantive insolvency laws of the various EU Member States were harmonised to a greater extent. However, interdependencies between intra-national laws (such as between national insolvency laws on the one hand and corporate laws on the other hand) are likely to bar the way to progressing a full harmonisation.

1.4.3 *Applicable treaties and case law*

There are no relevant treaties or additional case law to discuss.

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35 EIR Recast, art 7.
36 *Idem*, art 8 *et seq.*
37 InsO, s 335 *et seq.*

1.4.4 Upcoming new legislation

There is no upcoming new legislation with regards to this issue.

2. Substantive consolidated restructuring proceedings versus synthetic group restructurings

As previously noted, German insolvency law does not as such provide for the option to run a synthetic consolidated main group insolvency proceeding for multiple companies within a corporate group. In respect of each insolvent company, separate insolvency proceedings must be conducted.

The major legal obstacle for consolidated proceedings may be that German insolvency is still following a single entity approach which means that each company is subject to a separate insolvency proceeding and a separate insolvency test and thereby a clear distinction as to whether a company is insolvent or not. If a company is insolvent (because it is either over-indebted or cash-flow insolvent), the directors are under the obligation to, and creditors are entitled to, file for the opening of insolvency proceedings pursuant to statutory insolvency law.

In situations where multiple companies within one corporate group having their registered seat in different countries become insolvent and must apply for the opening of insolvency proceedings, it is often argued before the seized insolvency court that those companies have their COMI at the same location and, consequently, the same court is competent to open proceedings in respect of each of those companies with a view to concentrating the multiple proceedings. If the insolvency court accepts the argument and opens proceedings for each of those companies, foreign creditors often consider applying for the opening of secondary insolvency proceedings with insolvency courts in countries where the companies' registered seats are located because they fear being disadvantaged in foreign main proceedings and, therefore, prefer to have the local assets administered in an insolvency proceeding which is run in the company's "home country".

However, multiple proceedings may complicate the restructuring and / or sale of the group as a whole by the administrator of the main proceeding. For that reason, the main administrator has a preference to avoid the opening of secondary proceedings.

Pursuant to article 36 of the EIR Recast, the administrator may therefore give unilateral undertakings in respect of assets located in the Member State in which secondary insolvency proceedings could be opened that, when distributing those assets or the proceeds received as a result of their realisation, it will comply with the distribution and priority rights under national law that creditors would have if secondary proceedings were opened in that Member State. This scenario would be considered to give rise to synthetic secondary proceedings, and is given further attention below.

3. Duty to initiate insolvency process

There is a sufficient legal basis in German insolvency law for directors to not file for insolvency on the basis of a guarantee obtained by the company from an officeholder in another country. However, a guarantee would not be required to address simply that creditors would not be worse off than they would be if local proceedings would have been opened. The guarantee must rather ensure that the company does not become insolvent (i.e. cash-flow insolvent or balance sheet insolvent), insofar as it constitutes an enforceable and valuable claim for financing to the extent required to prevent the company from turning insolvent.

As mentioned above, cash-flow insolvency and balance sheet insolvency within the meaning of section 17 et seq. of the InsO triggers a mandatory obligation on the directors to file for insolvency. In principle, each managing director of a company (such as e.g. GmbH or *Aktiengesellschaft* (AG)) with its COMI in Germany is obliged to file for the opening of insolvency proceedings without undue delay and, in any event, no later than three weeks after the company has become cash-flow or balance-sheet insolvent.[38] If the directors of such companies fail to do so or fail to file in a timely manner, they will be subject to civil liability for, in principle, each and any payment of the company that is being made when the company is insolvent. Further, in such a case, the directors could be punished with imprisonment of up to three years or a fine.[39]

4. Legal certainty and predictability

There is no specific German legislation applicable to legal certainty or predictability.

5. Consolidation of assets

5.1 Procedure with respect to the sale of the whole or part of a business

This is touched on in the context of the German Scheme in section 1 above.

As is also discussed in section 1, in German in-court insolvency proceedings, each legal entity would be treated as a separate legal entity, independent from other companies within a group. There is no concept in German law which would allow for a consolidation of assets / debts. This means that approvals would need to be obtained from the relevant creditors of each individual company in administration.

As regards the procedure of a sale, the following is to be noted:

- on the basis of the current law, it is not possible to pre-package (i.e. pre-arrange or pre-solicit votes for) the insolvency procedure and a sale of the debtors' business.

  However, it is possible and good practice to adequately prepare the insolvency process and communicate with stakeholders at the pre-filing stage. In theory, it would be possible to enter into arrangements with certain stakeholders at this stage. However, this is rarely done for a variety of reasons. First, normally the timing for the filing is dictated by mandatory filing reasons, a concept which allows less flexibility to adequately prepare an insolvency case than in those jurisdictions where no mandatory filing obligations exist. Second, against the background of the existence of the mandatory filing reasons there always is a risk that, the longer the preparation takes, management is exposed to liability risks because retrospectively it might be argued by an officeholder that management had no reason to assume the company could be preserved as a going concern, and therefore factually delayed the filing. Third, pre-petition agreements are not binding on the debtor for legal reasons (in practice, such agreements are made subject to the condition precedent of necessary approvals / consents after

[38] *Idem*, s 15a para 1.
[39] *Idem*, s 15 para 4.

insolvency). As a consequence, stakeholders are less prepared to make commitments. Fourth, given the insolvency court's general discretion over whom to appoint as (preliminary) insolvency administrator, there is reluctance by stakeholders to make commitments due to the uncertainties that come along with the question of whom the court will appoint as administrator and which approach to restructuring the company such an administrator will ultimately take; and

- in insolvency proceedings, a sale of the whole or part of the business of an entity over whose assets insolvency proceedings have been opened requires the approval (in principle: simple majority) of the creditors' meeting.[40] If a creditors' committee is appointed by the court, the committee will need to be asked for its consent with regard to the sale of the business.[41]

5.2 Difference in treatment with respect to tangible and intangible assets

There is no difference in the process for tangible and intangible assets – in each case, consolidation is not possible under German insolvency law.

5.3 Role of the creditors and the creditors' committees in a substantive consolidation

As described in section 5.1 above, German insolvency law does not provide for a consolidation of assets / debts of group companies.

6. Equitable distribution and accountability of IPs

In German insolvency proceedings, a debt-to-equity swap is possible and does not require the consent of the debtor's shareholder(s).[42] However, a creditor cannot be forced to become a shareholder of the debtor by means of a debt-to-equity swap for constitutional law reasons. A swap is rather conditional upon the prior consent of the respective creditor.

7. Intercompany claims

7.1 Order of priority

Pursuant to German insolvency law, loans or other means of financing extended by: (i) a direct or indirect shareholder of an insolvent borrower with its COMI in Germany; or (ii) affiliates of an insolvent borrower which are controlled by a direct or indirect shareholder of the insolvent borrower are subordinated in right of payment in insolvency proceedings over the insolvent borrower.[43]

This subordination regime equally applies to equivalent transactions and also comprises transactions with third parties, such as third-party financing that is economically comparable to shareholder loans (e.g. where the third party is merely used as an intermediary). It should be noted that the German courts generally apply the subordination regime rather extensively and follow a highly economic approach in scenarios that are designed to circumvent the subordination regime.

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[40] *Idem*, s 160 paras 1, 2.
[41] *Idem*, s 160 para 1.
[42] *Idem*, s 225a para 2.
[43] *Idem*, s 39 paras 1 no 5, 4.

In the case of insolvency of the borrower, payments to the shareholder (made prior to the opening of insolvency proceedings) in respect of such shareholder loans or equivalent transactions can be clawed back with a look-back period of one year from the filing for the opening for insolvency proceedings.[44] Further, any security granted by the borrower in respect of such a shareholder loan can be clawed back with a look-back period of up to 10 years from the filing for the opening of insolvency proceedings.[45]

7.2 Concepts that can alter priority

The relevant subordination and claw back principles are outlined above.

8. Administering a complex estate in one single consolidated procedure

As there is no concept of consolidated group proceedings under German insolvency law, each legal entity is to be treated as distinct from the other group companies for insolvency purposes rather than creating multiple groups within an enterprise group for insolvency purposes.

9. Handling an insolvent parent with a healthy subsidiary

As there is no concept of group proceedings under German insolvency law, solvent subsidiaries would not be consolidated within an insolvent group proceeding, either substantively or procedurally. German insolvency law does not allow a release of up-stream guarantees. Solvent subsidiaries may therefore be called upon to contribute to the estate of the insolvent parent under such guarantees for the benefit of the parent. This can lead to a domino effect such that one case of insolvency causes the insolvency of further group companies.

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[44] *Idem*, s 135 para 1 no 1.
[45] *Idem*, s 135 para 1 no 2.

HONG KONG

1. Consolidated group restructurings versus cooperation or coordination procedure

1.1 Corporate group versus individual legal entity

1.1.1 The insolvency and restructuring systems that are in force

The principal legislation in Hong Kong in relation to corporate insolvencies is the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32), supplemented by the Companies (Winding up) Rules (Cap 32H). Some provisions of the Bankruptcy Ordinance (Cap 6) also apply to corporate insolvencies in Hong Kong.

As far as the legislation and rules are concerned, Hong Kong insolvency law only applies to single legal entities and not to groups of entities.

1.1.2 Definition of a corporate group

Under section 2 of the Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap 32) and section 2 of the Companies Ordinance (Cap 622), a "group of companies" is defined as "any two or more bodies corporate one of which is the holding company of the other or others." This definition is for corporate finance and reporting purposes.

1.1.3 Legislation relating to corporate groups

There is no specific legislation relating to corporate groups. The long-awaited Hong Kong Corporate Rescue Bill has been the subject of multiple delays and has not yet been officially introduced – but even if it is eventually introduced and adopted, this will not provide for any concept of corporate group insolvency or consolidation.

1.2 Corporate group versus individual corporate benefit

1.2.1 The existence and relevance of "corporate group benefits"

The doctrine of corporate group benefit does not exist in Hong Kong either by law or in case law.

In the Australian case of *Walker v Wimborne*,[1] Mason J upheld the principle of the separate legal entity as a matter of corporate and insolvency law and stated that, in terms of conferring corporate benefits on other group members, it is subject to the fundamental rule that an insolvent company must not deal with its property to the detriment of creditors.

It is likely that Hong Kong would follow this approach.[2]

1.2.2 Director liability

Because there is no concept of corporate group benefit in Hong Kong, directors owe their duties to the individual company to which they are appointed, rather than any broader corporate group as a whole that the individual entity may belong to.

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[1] (1976) 50 ALJR 446.

[2] See *Hong Kong Corporate Law*, LexisNexis, [805]–[850].

1.2.3 "Early warning systems"

There are no "early warning systems" in Hong Kong requiring directors of individual companies within a corporate group to report to the parent entity in circumstances of financial distress.

1.2.4 Pending or draft legislation

There is no pending or draft legislation on these issues in Hong Kong at present.

1.3 Universalism versus territorial principle

1.3.1 Application of the modified universalism rules

The Hong Kong insolvency legislation is not based on modified universalism. Rather, parallel insolvency proceedings in different countries are permitted. The Hong Kong court may then grant assistance to foreign liquidators as a matter of common law. In that regard, see for example *Re CEFC Shanghai International Group Ltd*,[3] where the court held that Hong Kong should follow the universalism trend in the common law world, but the focus there was on the recognition and assistance aspects as opposed to the opening of ancillary proceedings.

1.3.2 Bilateral and / or multilateral treaties in force

Hong Kong relies solely on the common law. Hong Kong is not a party to the United Nations Commission on International Trade Law (UNCITRAL) Model Law (Model Law).

However, on 14 May 2021, the Hong Kong Government and the Supreme People's Court (SPC) of the People's Republic of China signed a joint Record of Meeting on mutual recognition of and assistance to bankruptcy and insolvency proceedings between the courts of the Mainland and of Hong Kong.

According to the Record of Meeting:

- the SPC will designate 'pilot areas' in which Intermediate People's Courts (IPCs) in Mainland China may initiate cooperation with Hong Kong courts in relation to mutual recognition and assistance in bankruptcy and insolvency matters;

- a liquidator or provisional liquidator in Hong Kong insolvency proceedings may then apply to the relevant IPC in a pilot area in the Mainland for recognition of the liquidation or provisional liquidation that is being undertaken in accordance with the laws of Hong Kong, as well as recognition of and assistance in the discharge of the duties of the liquidator or provisional liquidator;

- an administrator in bankruptcy proceedings in Mainland China may apply to the High Court of Hong Kong for recognition of either bankruptcy liquidation, reorganisation or compromise proceedings under the Enterprise Law of the PRC (Enterprise Law), as well as recognition of and assistance in the discharge of the duties of the relevant administrator; and

[3] [2020] HKCFI 167.

- the application procedure will take place in accordance with the process of the relevant court to which an application is made.

Apart from this specific bilateral recognition and cooperation framework with Mainland China, Hong Kong does not have in place any similar country-to-country framework with any other nation, nor does it have a broader framework for multilateral cooperation.

On 20 July 2021, Justice Harris made orders in *Re Samson Paper Company Limited*,[4] issuing the first ever letter of request (in this case, to the Shenzhen IPC) under the new recognition framework in connection with the liquidation of Samson Paper Company.

1.3.3 Pending legislation

There are no changes in legislation envisaged in the near future.

1.4 Competent court and applicable law

1.4.1 Applicable law that falls outside of the lex fori concursus and related issues

Generally speaking, Hong Kong courts use the place of incorporation of a company to identify the principal jurisdiction governing the insolvency or restructuring procedures. For example, where a Hong Kong company is a subsidiary of a foreign company, the starting point should be that the principal jurisdiction for the winding up of the Hong Kong company would be Hong Kong. Similarly, where a Hong Kong company has an overseas subsidiary, the starting point should be that the principal jurisdiction for the winding up of the foreign subsidiary would be the foreign jurisdiction. These decisions are evidently all subject to the courts' discretion.

The centre of main interests concept is not relevant in Hong Kong.

1.4.2 Harmonisation of substantive restructuring and insolvency laws

Substantive harmonisation would encounter significant difficulties in Hong Kong and is unlikely to be pursued in the near future.

1.4.3 Applicable treaties and case law

Hong Kong relies on the common law only, in the manner outlined above.[5]

1.4.4 Upcoming new legislation

There is no upcoming new legislation.

2. Substantive consolidated restructuring proceedings versus synthetic group restructuring

There are no synthetic consolidated group restructurings under Hong Kong legislation or case law, but the court might adopt a flexible approach.

[4] [2021] HKCFI 2151.
[5] See, for example, *Re CEFC Shanghai International Group Ltd* [2020] HKCFI 167.

Where a foreign company is in liquidation in its country of incorporation, it may be possible to obtain a winding up order in Hong Kong ancillary to that being conducted abroad. Similarly, and under principles of comity, the Hong Kong courts will, under certain circumstances, recognise insolvency procedures and orders made by foreign courts against a local debtor. In addition, in appropriate cases and on appropriate terms, the Hong Kong court will cooperate with a foreign court if there are concurrent rescue or insolvency proceedings in another jurisdiction.[6]

3. Duty to initiate insolvency process

Filing in bankruptcy is not a mandatory obligation that rests upon the directors under Hong Kong laws. Accordingly, the potential for a guarantee provided by an insolvency practitioner (IP) in a foreign country to relieve directors of any such obligation is not applicable in Hong Kong.

4. Legal certainty and predictability

Again, because there is no positive obligation for directors in Hong Kong to file for bankruptcy, the possibility of using a guarantee provided by an IP in a foreign country to directors of a local company in Hong Kong as the basis for refraining from proceeding with a filing – and measures to provide certainty and predictability to local creditors, ensure appropriate communication with local courts and creditors, and to appropriately structure the terms of the guarantee – do not arise in Hong Kong.

5. Consolidation of assets

5.1 Procedure with respect to the sale of the whole or part of a business

There is no specific procedure for a sale of the whole or part of a business.

There is no general doctrine of substantive consolidation / pooling of assets in Hong Kong. Only in very limited circumstances is the separate legal personality of a company ignored (for example, in the case of fraud).

The pooling of assets and liabilities in Hong Kong is based on judicial discretion rather than the consent of creditors or shareholders, and pooling is only allowed when it appears that it is the best or only method of distributing assets back to creditors.

Regarding the procedures, the IP must make an application to court stating the facts of the case and the reasons why this method is required. A court hearing will then be scheduled to determine the merits of the application. Creditors must be given notice of the hearing and the proposal. The court will either grant an order allowing the pooling of assets and setting out the terms for distribution, or request further steps to be undertaken, based on the arguments presented at the court hearing.

5.2 Difference in treatment with respect to tangible and intangible assets

There is no difference in treatment between tangible and intangible assets in Hong Kong.

[6] See, for example, *Re LDK Solar Co* [2015] 1 HKLRD 458.

5.3 Role of the creditors and the creditors' committees in a substantive consolidation

This is not applicable to Hong Kong.

5.4 Voting for or against a substantive consolidation

This is not applicable to Hong Kong.

6. Equitable distribution and accountability of IPs

The procedure best suited for "cramming down" creditors (in the sense of obliging all creditors to be bound to a restructuring plan) is through a scheme of arrangement, which is practically identical to the English scheme regime. If the necessary majority is achieved (75% in value and more than 50% in number at a meeting of each class of creditors), the scheme is subsequently sanctioned by the court and then the relevant court order is registered with the Hong Kong Registrar of Companies and the scheme will become binding on all the company's creditors within the class(es) affected by the scheme. However, note that the existence of dissenting creditors may in certain cases affect the ability to get the scheme sanctioned by the court, as the court will consider (among other things) whether those attending and voting at each meeting fairly represent the relevant class and that the relevant majority have in each case acted *bona fide* and not promoted interests adverse to the rights of the class they purport to represent.[7]

7. Intercompany claims

7.1 Order of priority

Intercompany claims are enforceable in the same manner as ordinary third-party creditors' claims.

7.2 Concepts that can alter priority

There are no concepts of re-characterisation of intercompany debt as equity or equitable subordination under Hong Kong insolvency laws.

8. Administering a complex estate in one single consolidated procedure

This is not applicable in Hong Kong. As noted above, there is no general principle allowing for consolidated group restructurings in Hong Kong.

9. Handling an insolvent parent with a healthy subsidiary

There is no legislation in Hong Kong permitting solvent subsidiaries to be consolidated within an insolvent group proceeding.

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[7] See, for example, *UDL Argos Engineering & Heavy Industries v Li Oi Lin* (2001) 4 HKCFAR 358.

IRELAND

1. Consolidated group restructurings versus cooperation or coordination procedure

The legal system in Ireland, and company law in particular, does not provide specifically for the restructuring of consolidated corporate groups. There are circumstances, however, whereby companies within a group can be restructured together.

The Irish preventative and / or debt restructuring process of examinership is comparable to the United States Chapter 11 process. In an examinership, a company is placed under the protection of the court, the debtor remains in possession and a court-appointed examiner investigates the company's affairs and prospects. Legislation provides that during the period of protection, which lasts for an initial period of 70 days, no proceedings may be instituted against the company, including the enforcement of security or winding up the company. If the examiner believes the company can survive as a going concern, he or she will propose a compromise or scheme of arrangement, which if approved by a majority in number and value of at least one class of creditors may then be sanctioned by the court and become binding.

The legislative provisions which govern examinership do specifically recognise the concept of "related companies". A related company is defined and includes, for example, a holding company or subsidiary. The Companies Act 2014 (Act) provides that when a court appoints an examiner to a company, it may extend the examinership to a related company or companies. In making such an extension, the court must have regard to "whether the making of the order would be likely to facilitate the survival of the company, or of the related company, or both, and the whole or any part of its or their undertaking, as a going concern."[1]

The examiner must prepare a compromise or scheme of arrangement for the company as soon as practicable after being appointed. There is very little, if any, limit on the nature of the restructuring which can be proposed whether it be debt reduction, debt for equity or another proposal. There are certain protections for secured creditors and limits on the extent to which certain contractual terms can be varied without consent, although it is possible to disclaim contracts, including leases, in their entirety.

For example, section 537 of the Act enables the company, subject to court approval, to affirm or repudiate any contract under which an element of performance other than payment remains to be rendered by both parties. This has been used extensively in the retail sector as a means of closing down non-performing stores.

The examiner must convene, on at least three days' notice, meetings of the creditors of the company and a meeting of the members to explain the impact of their proposals. At the meetings, amendments may be suggested to the examiner's proposals.

For the examiner's proposals to be deemed to be approved by a class of creditors, the proposals must be approved by a majority in number representing a majority in value of debt within that class. This is a significantly lower threshold than is required for other insolvency or restructuring processes. The court cannot approve the examiner's proposals unless at least one class of creditors that would be impaired by the proposals votes in favour of it. Before providing approval, the court will also consider

[1] Act, s 517(2).

whether the proposals are fair and equitable for the creditors. The creditors may attend the court hearing where the proposals are presented and outline any basis upon which they maintain they would be unfairly prejudiced by the proposals, if approved.

A scheme of arrangement[2] is a statutory procedure which can be used to restructure a company by way of a proposed compromise or arrangement between a company and its creditors or any class of them without the appointment of an insolvency practitioner (IP). It can be preventative, in aid of debt reduction, or as part of an insolvent liquidation. The legislation requires a separate scheme and procedure for each corporate entity but schemes can in theory be run in parallel for a number of companies within a group.

Directors can convene the scheme meetings without court approval, provided a majority in number representing at least 75 per cent in value of the creditors or class of creditors approve the scheme. The court can then be asked to sanction the scheme and, if it does so, the scheme becomes binding on all affected creditors and the company.

The court may, on its own initiative or on the application of an affected party, review the classification of creditors and the fairness of the scheme. This typically happens during an application by the examiner to have the scheme sanctioned by the court.

Additionally, on 7 December 2021, the Companies (Rescue Process for Small and Micro Companies) Act 2021 (SCARP) came into effect.

SCARP amends the Act to establish a new rescue process for small and micro companies that are, or are likely to be, unable to pay their debts. This new process is modelled on the examinership process, but has been tailored for small and micro companies. Due to the reduced role of the court in the process, SCARP should be a more accessible and cost-efficient process.

The requirements for an eligible company to meet if it wishes to avail of a rescue plan include that:

- the company is, or is likely to be, unable to pay its debts; and
- the directors of the company have not utilised this or a similar process in the previous five years.

A company is a small company if any two of the following conditions are satisfied:

- the turnover of the company does not exceed € 12 million;
- the balance sheet of the company does not exceed € 6 million; and
- the average number of employees does not exceed 50 people.

A company is regarded as a micro company if two or more of the following numerical conditions are satisfied:

- the turnover of the company does not exceed € 700,000;

[2] Act, Pt 9.

- the balance sheet of the company does not exceed € 350,000; and

- the average number of employees does not exceed 10 people.

The key features of the new process under SCARP are:

- the directors must prepare a statement of affairs setting out the financial situation of the company and confirm by statutory declaration that they have made a full inquiry into the affairs of the company;

- this statement and statutory declaration are provided to the intended process adviser (PA), expected to be an IP, who then determines whether there is a reasonable prospect of survival of the company as a going concern;

- the company must then pass a resolution to appoint the PA within seven days of receipt of the PA's report, without any need for a court application;

- the PA must immediately begin preparing a rescue plan for the company;

- the creditors of the company will receive notice of the appointment of the PA and should consider whether they object to inclusion of their debt in the process;

- if at any point the PA deems that there is no longer a reasonable prospect of survival of the company, the PA must notify the directors and resign;

- the PA must call meetings of the creditors as soon as possible to consider the rescue plan and not later than 49 days after the date of the passing of the directors' resolution;

- the rescue plan will be deemed to be accepted once 60% in number representing the majority in value of the claims represented at that creditor class meeting have voted in favour of the rescue plan;

- where the rescue plan is approved the PA must notify the employees, the Revenue Commissioners and any impaired creditor or member within 48 hours; and

- the rescue plan is then binding on the company, members, creditors and directors once 21 days have passed from a court filing of the notice of approval and where no objection has been filed.

There is no automatic protection from creditors during the SCARP process.

However, upon application to the relevant court, a stay on creditor enforcement actions will be available. This may be important where there is a threat of creditor action that could jeopardise the ongoing trade of the business.

1.1 Corporate group versus individual legal entity

1.1.1 The insolvency and restructuring systems that are in force

Companies in Ireland enjoy separate legal personality and Ireland's insolvency and restructuring laws regard each company as a separate legal entity. There are a very small number of what are, in effect, statutory exceptions such as where a related company can be made liable for some or all of the debts of another. These limited exceptions are subject to court sanction as follows.

In Ireland, pooling orders (substantive consolidation) in insolvency have been on a statutory footing since their introduction in section 141 of the Companies Act 1990.

Section 600 of the Act now replicates the earlier provision and states:

> "Where two or more related companies are being wound up and the court … is satisfied that it is just and equitable to do so, it may [order that] the companies shall be wound up together as if they were one company."

In deciding whether it is "just and equitable" to make the pooling order, the court must have regard to a number of factors, including the extent to which any of the companies took part in the management of any of the other companies and the conduct of any of the companies towards the creditors of any of the other companies.

Contribution orders have also been on a statutory footing in Ireland since 1990. Section 599 of the Act now permits the court to make an order that any company that is or has been related to the company being wound up shall pay to the liquidator of that company an amount equivalent to the whole or part of all or any of the debts provable in that winding up. The order can be made on application by the liquidator or any creditor or contributory "if it is satisfied that it is just and equitable to do so."

In deciding whether it is just and equitable to make an order, the court must consider the extent to which the related company took part in the management of the company being wound up and the effect which such an order would have on the creditors of the related company.[3]

In practice, there are very few such orders made. This is due to a number of factors including, the level of proof required, the risk of speculative litigation, the lack of funds available to litigate and the uncertainty about the financial ability of the contributing company to make the payment, if ordered.

1.1.2 Definition of a corporate group

The Act recognises a legal group concept in certain scenarios. The concept has a wide application throughout the Act and examples other than those alluded to above include provisions on loans to directors and connected persons in relation to intra-group transactions,[4] and group financial statements and consolidated accounts.[5]

In the context of audit exemptions, section 359(1) of the Act defines a "group company" as a company that is a holding company or a subsidiary undertaking and provides that "undertakings are associated if one is the subsidiary undertaking of the other or both are subsidiary undertakings of a third undertaking."

[3] Act, s 599(4).
[4] Act, s 243.
[5] Act, Pt 6 (ss 272-407).

1.1.3 Legislation relating to corporate groups

There are at present no draft laws providing for a corporate group concept.

1.2 Corporate group versus individual corporate benefit

1.2.1 The existence and relevance of "corporate group benefits"

Under the Act, the doctrine of *ultra vires* has been abolished for private limited companies (LTDs).

For other forms of company – such as public limited companies (PLCs) and designated activity companies (DACs) – the *ultra vires* rule has been modified by the Act, such that the validity of an act done shall not be called into question on the grounds of lack of capacity by reason of anything contained in the company's constitution.

In the context of common law interpretation, the principle which is applied is that if the corporate act is for the overall benefit of the group, then clearly it must have some benefit for individual members of the group. While the directors' primary duty is to act in the best interests of each specific company and not in the interests of the group as a whole, nevertheless it is recognised that it is often advantageous for one company to support other members of the group.

In *Re: PMPA (Garage) Longmile Limited,*[6] Judge Murphy considered whether there is commercial benefit to one member of the group where it enters into a guarantee for the benefit of another member of the group. Murphy J concluded:

> "In the nature of things companies associated with each other as parent and subsidiary or through common shareholders or who share common management and common titles or logos cannot safely ignore the problems of each other. Even the most independently minded director of any such related company seeking to advance the interests of a particular company would necessarily recognise that he should and perhaps must protect the interests of the group as a whole or else to take steps to secure that the particular company disassociates itself from the group."

The more recent case of *John P. Greene & Ors v Danny Coady & Ors*[7] looked at corporate benefit in the context of a group of companies. Judge Charleton said that:

> "there must be a valid reason and every payment must be representative of value taking into account the directors' duty of care and fidelity to their own company and how the interests of the group impact on that…. A company does not have a legal capacity to throw away its money. Even within a group, each payment must be scrutinised by the board of directors, and by the accountants signing off on accounts, as a transaction that is economically justified in terms of the benefit to the company and the corporate benefit to the group as to the balance between what is being paid and what is returned for that remuneration. A dividend is the legitimate way for a company to

[6] [1992] ILRM 337.
[7] Unreported, High Court 4 February 2014.

> make a distribution to its members. Over-payment for services or goods by a company to a related company can be a breach of directors' duties where the analysis of benefit to the company through the transaction and benefit to the group that supports the company is not shown. Directors in the exercise of their fiduciary capacity must not authorise payments that are not made for the benefit of the company within the context of a group of companies."

It is generally recognised, however, that while intra-group trading or the provision of services may justify, for example, the giving of a cross group guarantee and the existence of co-sureties can reduce the risks run by individual subsidiaries, it does get that bit more difficult where the connections between group companies are remote and there is little intra-group trading and consequent apparent benefit. Directors should assess this on a case by case basis and may in fact have to rely on ratifying resolutions by the parent company (as shareholder of their company) to cure any potential breach of duty to the company.

1.2.2 *Director liability*

Part 5 of the Act provides a comprehensive statement of directors' duties, codifying fiduciary duties and consolidating many common law and statutory duties of directors.

It is clear that, while directors may have regard to the interests of certain stakeholders (for example employees by virtue of section 224 of the Act), and while (as noted above) the interests of the overall group may be taken into account, ultimately the duties are owed to each company alone and there is no accommodation or recognition of duties owed to a corporate group.

1.2.3 *"Early warning systems"*

Section 1111 of the Act mandates the calling of a meeting of shareholders where the net assets of a PLC are half or less of the amount of the called-up share capital. The purpose of the meeting is prescribed as being to consider "whether any, and if so what, measures should be taken to deal with the situation." This provision only now applies to a PLC, which is a form of company which may offer / list its shares and debt securities for public subscription.

1.2.4 *Pending or draft legislation*

There is no pending or draft legislation dealing with these issues.

1.3 Universalism versus territorial principle

1.3.1 *Application of the modified universalism rules*

The European Insolvency Regulation (EIR)[8] and the EIR Recast[9] are in force in Ireland. Indeed, one of the seminal cases on ancillary proceedings pursuant to the EIR, the *Eurofood* case,[10] involved a decision by the Irish Court to open main proceedings in Ireland by reference to the Irish company's centre of main interests (COMI).

[8] Council Regulation (EC) No 1346/2000 of 29 May 2000.
[9] Regulation (EU) 2015/848 of the European Parliament and the Council of 20 May 2015 on Insolvency Proceedings.
[10] C-341/04 – Eurofood IFSC, Judgment of the Court (Grand Chamber) of 2 May 2006, reference for a

However, in *Rathville Ltd v The McArthur Group Ltd (McArthur Group),*[11] the McArthur Group Ltd (incorporated in the United Kingdom in 1945, with a branch registered in Ireland) was in administration in the United Kingdom. The petitioning Irish creditor was apprehensive as to what might happen in the United Kingdom insolvency proceedings, and applied for the appointment of a provisional liquidator, in secondary insolvency proceedings in relation to the company.

In terms of synthetic proceedings and despite evidence of additional costs of liquidation and assurances given that local priorities would be observed, Judge Charleton observed:

> "Turning to the question of, to what extent will the prime insolvency proceedings bypass the secondary obligations? I heard counsel on behalf of the United Kingdom administrator in that regard and I am certain that they are acting in good faith. There is a serious issue, notwithstanding that, as to how the collection of fiduciary taxes in Ireland will be ranked in terms of priority in the United Kingdom proceedings. Some assurance has been given to this Court in that regard. Equally, however, the degree of assurance that is available is not the degree of assurance whereby the court can say that it is now certain that priority will be accorded to the Revenue Commissioners in the same way as if a secondary insolvency proceeding were allowed to continue by way of an order of the court in liquidation here."

Beyond the European Union (EU), Ireland has a strong common law tradition (and jurisprudence) on the recognition and enforcement of judgments and comity between courts.

For completeness, section 1417(1) of the Act, which provides that any order made by a court of "any state recognised for the purposes of this section" and made for, or in the course of, winding up a company may be enforced by the High Court in the same manner in all respects as if the order has been made by the High Court.

"Recognised" means recognised by ministerial order and only in relation to non-EU Member States and Denmark. However, to date, no ministerial order has been made to give effect to this section. This section has been on the statute books for some time and its predecessor was similarly redundant, with only the United Kingdom having been recognised prior to the EIR and the EIR Recast.

To enforce a judgment from a non-EU/EFTA country, it is necessary to rely on Irish common law rules of enforcement. These rules include provisions to the effect that the judgment must have been obtained from a court of competent jurisdiction, which had the requisite jurisdiction in respect of the particular claim, and enforcement of the judgment must not be contrary to Irish public policy.

In *Re: Drumm (a Bankrupt): Dwyer, applicant,*[12] Judge Dunne made an order in aid of the United States Federal Bankruptcy Court and made specific orders declaring that all property of the bankrupt, including specified real estate in Ireland, vested in the

preliminary ruling: Supreme Court – Ireland.

[11] [2014] IEHC 355.

[12] [2010] IEHC 546.

United States trustee in bankruptcy. Various authorities, including *Cambridge Gas Transportation Corporation v Official Committee of Unsecured Creditors of Navigator Holdings Plc and Ors* (*Cambridge Gas*),[13] were considered by the court. Judge Dunne said she was satisfied that the court had the inherent jurisdiction to make the order and said "I can see no reason of public policy for refusing to assist the trustee in bankruptcy in this case in the manner sought. On the contrary, it seems to me that it is to the benefit of the creditors of the bankrupt to facilitate the trustee in this case."

In *Re: Flightlease (Ireland) Ltd (in Voluntary Liquidation) (Re Flightlease),*[14] the Supreme Court of Ireland considered the application of conflict of law rules in an insolvency context.

Flightlease arose from a dispute between the liquidators of two companies which went into liquidation as part of the collapse of the same group. Flightlease was a company established and based in Ireland. In the liquidation of Swissair, an application was before the Swiss courts seeking the return of certain moneys paid by Swissair to Flightlease. The question at issue was whether, on application of the common law rules, a decision of the Swiss court would be recognised and enforced in Ireland. Ultimately, this turned on whether the Swiss court was a court of "competent jurisdiction" for the purpose of the rules on recognising and enforcing foreign judgments against the Irish company.

The Supreme Court stated:

> "Such an order will only be enforced in this jurisdiction if Flightlease is present in Switzerland at the commencement of the action or has submitted to the jurisdiction of the Swiss Court. Neither is the case."

The Supreme Court also refused to follow the approach taken in *Cambridge Gas* on the basis that that the approach was dependant on the specific statutory framework of the United Kingdom *Insolvency Act 1986*, the Cross Border Insolvency Regulations 2006 and the UNCITRAL Model Law on Cross-Border Insolvency, and did not extend the common law position.

Fairfield Sentry Ltd (In Liquidation) v Citco Bank Nederland NV[15] was a judgment of Judge Finlay-Geoghegan delivered five days after the Supreme Court decision in *Re Flightlease*. Judge Finlay-Geoghegan granted an order recognising the liquidators appointed in the British Virgin Islands (BVI) to a BVI company and said:

> "In my judgment, it is correct that pursuant to the common law in Ireland, the court has an inherent jurisdiction to recognise orders of foreign courts (in the sense of non-EU courts) for the winding up of companies and the appointment of liquidators."
>
> Earlier in this judgment I agreed with the statement by Lord Hoffman in *Cambridge Gas* that as a matter of common law the principle of universality of insolvency proceedings is given effect by recognising the person who is empowered under the foreign bankruptcy law to act on behalf of the insolvent company as entitled to do so in Ireland.

[13] [2006] 3 WLR 689.
[14] [2012] IESC 12.
[15] [2012] IEHC 81.

> As pointed out, the common law is undeveloped in relation to any further assistance to be given to foreign liquidators.
>
> On the facts herein, such principle is given effect to by the recognition by the Irish courts of the entitlement of the liquidator to maintain on behalf of Fairfield the proceedings in this jurisdiction seeking declarations in relation to Fairfield's entitlement to the monies in the Dublin Account."

Re Mount Capital Fund Limited (In Liquidation) (Re Mount Capital)[16] is another case involving liquidators appointed in the BVI to a BVI company. Judge Laffoy was asked to make an order authorising the liquidators to synthetically exercise the powers afforded to an official liquidator under section 245 of the Companies Act 1963 (since repealed and replaced) in order to assist the liquidators in accessing books, records, assets and properties of the company in Ireland.

Judge Laffoy expressed the issue as follows:

> "The dilemma with which this Court is faced is whether the decision of the Supreme Court precludes this Court from following the approach adopted by Finlay Geoghegan J in the Fairfield case in finding that this Court has inherent jurisdiction to recognise orders of a Court outside the European Union ordering the winding up of a company, the appointment of a liquidator and giving liberty to the Liquidator to apply for assistance in aid of the Court making the order."

Ultimately, Judge Laffoy concluded that the analysis in *Re Flightlease* was limited in application to enforcement at common law of a "liability to pay a sum" on foot of a judgment made by a foreign court in liquidation proceedings being conducted in this jurisdiction in accordance with Irish law. She found that it did not preclude her from giving recognition to orders of the type made by the High Court of Justice of the BVI in relation to the companies in the case before her.

The High Court has subsequently recognised and given effect to a Swiss law restructuring moratorium in relation to Valartis Group AG.[17] Although there is no publicly available court judgment, the report cited indicates:

> "Following an application to the High Court that was founded upon the similarities between the Swiss law process and examinership, the High Court recognised the Swiss Order. In particular, the High Court recognised and gave effect to the protection afforded by the Definitive Moratorium to the Company including the restriction on any creditor issuing any debt recovery proceedings or excising any legal rights against the Company under Irish law."

1.3.2 Bilateral and / or multilateral treaties in force

See the discussion above in relation to the EIR, the EIR Recast and the related case law.

[16] [2012] IEHC 97.
[17] http://www.ifsc.ie/feature.aspx?idfeature=167798.

1.3.3 Pending legislation

No specific changes are currently anticipated.

1.4 Competent court and applicable law

As noted above, the EIR and the EIR Recast are in force in Ireland.

It is a required proof in all domestic cases to establish jurisdiction by showing that the company has its registered office and conducts its business from Ireland.

Alternatively, it must be shown that the company is otherwise capable of being wound up under the Act. The latter category includes certain foreign companies provided that: there is a sufficient connection with Ireland; the order will benefit those applying for it; and the court can exercise jurisdiction over one or more persons interested in the distribution of the company's assets. The relevant legislative provision, section 1328 of the Act, is seldom used although was recently considered but not applied by Judge Laffoy in *Re Harley Medical Group (Ireland) Limited.*[18] Judge Laffoy cited with approval the criteria identified from the equivalent provisions in the United Kingdom in the case of *Stocznia Gdanska SA v Latreefers Inc (No2),*[19] including that sufficient connection may, but does not necessarily have to, consist of assets within the jurisdiction.

1.4.1 Applicable law that falls outside of the lex fori concursus and related issues

This is largely determined by the EIR and the EIR Recast.

1.4.2 Harmonisation of substantive restructuring and insolvency laws

Harmonisation would certainly help in terms of limiting the number of secondary or satellite proceedings and thereby avoiding the costs and protraction of proceedings of the kind seen in the case of *McArthur Group*, referred to above.

1.4.3 Applicable treaties and case law

The EIR and the EIR Recast are primarily relevant in this context, and the key cases are outlined above.

1.4.4 Upcoming new legislation

There is no upcoming new legislation in relation to these issues.

2. Substantive consolidated restructuring proceedings versus synthetic group restructurings

While, as noted, consolidated corporate group proceedings are not specifically provided for under Irish law, there is potential for the courts to allow, in effect, synthetic restructurings and insolvency processes to take place under the EIR, the EIR Recast and according to common law principles, rather than opening ancillary

[18] [2013] IEHC 219.
[19] [2000] TLR 182.

proceedings. The relevant case law in that regard is outlined above (see, for example, in *Re Mount Capital*).

3. Duty to initiate insolvency process

As a matter of Irish law, there is no specific obligation on directors to file for bankruptcy. Rather, there is a combination of statutory duties owed to the company (and a common law duty to creditors of the company when it is insolvent) and prohibitions on certain activities at a point when the directors know or ought reasonably to know that the company is insolvent.

In seeking to comply with those duties, there is a legal basis upon which directors could decide, subject to appropriate guarantees from an IP in another country, not to open a proceeding Ireland. However, the directors would probably be advised to make it a condition of their support that the foreign proceedings be formally recognised in Ireland.

Further, there is no certainty that a local creditor might not seek a proceeding in Ireland even if such a guarantee was provided by a foreign IP, and the *McArthur Group* case, referenced above, is an example of where secondary proceedings may still be opened.

4. Legal certainty and predictability

4.1 Legal certainty and predictability to local creditors

A formal register or recognition process would be beneficial. However, as noted above, if a guarantee was provided, there is no absolute certainty that a creditor would not still initiate a secondary insolvency process in Ireland in any event.

4.2 Communications with local courts and creditors

For EIR and EIR Recast cases, publication and registration and lines of communication is as prescribed in EIR and EIR Recast. For non-EU cases, these issues are at the discretion of the court.

4.3 Guarantees by the IP in office

The terms of any guarantee provided are not specifically regulated by Irish law.

5. Consolidation of assets

5.1 Procedure with respect to the sale of the whole or part of a business

As noted above, companies in Ireland enjoy separate legal personality and Irish insolvency and restructuring laws regard each company as a separate legal entity. There are a very small number of what are in effect, statutory exceptions. Notably, pooling orders (substantive consolidation) in insolvency are permitted under section 600 of the Act, so that companies can be wound up together as if they were one company if the court is satisfied it is just and equitable to do so.

5.2 Difference in treatment with respect to tangible and intangible assets

The statutory exceptions to the separate legal entity doctrine in the context of group restructurings do not apply differently depending on whether the assets are tangible or intangible.

5.3 Role of creditors and creditors' committees in a substantive consolidation

Any statutory pooling order is determined by the court and not creditors.

5.4 Voting for or against a substantive consolidation

This issue does not arise in Ireland, as any statutory pooling order is determined by the court.

6. Equitable distribution and accountability of IPs

6.1 Liquidation

The *pari passu* principle is one of the most fundamental principles of insolvency law and means that creditors in the same class share equally any available assets of the company or individual, or any proceeds from the sale of any of those assets, in proportion to the debts due to each creditor.

Creditors and contributories rank in the following order:

- fixed charges / liens in order of the priority of their creation;
- super-preferential debts. These are certain statutorily defined employee contributions due to the Social Insurance Fund (comprising employees' social insurance contributions), which are excluded from the assets available on a winding-up and are therefore accorded a heightened priority;
- the fees, costs and expenses of an examiner, if one was appointed prior to the liquidation;
- the costs and expenses of the winding up;
- the fees due to the liquidator;
- certain social welfare claims;
- preferential debts (for example, tax liabilities). These are defined in statute and include:

    i. local authority rates;

    ii. capital and income taxes;

    iii. claims of employees; and

    iv. wages, salaries, redundancy payments and so on.

Preferential claims have priority over the claims of debenture holders under any floating charge, and (if necessary) will be paid out of any property comprised in or subject to such charge;

- uncrystallised floating charges in order of their creation;
- unsecured debts;
- deferred debts; and
- shareholders.

In a solvent liquidation, any remaining surplus after payment to creditors will be distributed among the members of the company. In an official liquidation, the court is under a duty to determine which member-contributories are entitled to which assets.

6.2 Restructuring

The relevant priorities will be determined under an examinership or scheme of arrangement in the manner outlined above. The legislation is very flexible in terms of the nature of any scheme which may be proposed.

7. Intercompany claims

7.1 Order of priority

The presumption would be that claims of a parent or affiliate company are ranked *pari passu*.

7.2 Concepts that can alter priority

Under Irish law, there is no concept of "equitable subordination" or the "re-characterisation" of intercompany debt as equity.

8. Administering a complex estate in one single consolidated procedure

In Ireland, the legislation does not recognise enterprise groups or sub-groups for insolvency purposes.

9. Handling an insolvent parent with a healthy subsidiary

No legislation exists in Ireland to recognise enterprise groups or sub-groups for insolvency purposes. In addition, examinership (restructuring) and insolvency procedures are only available for insolvent companies. A scheme of arrangement (restructuring) could be used to provide for a healthy subsidiary but it would require the creditors of that entity to approve the consolidation.

ITALY

1. Consolidated group restructurings versus cooperation or coordination procedure

Consolidated group restructurings have not been available under Italian law for a long time, although special provisions of law are applicable to the insolvency of group entities in the framework of the extraordinary administration proceedings for large insolvent companies (i.e. *amministrazione straordinaria*).

Such rules are: (i) based on a general principle of separation of assets and liabilities of each entity of the group; but also (ii) aimed at ensuring cooperation and coordination among the proceedings regarding such entities.

Furthermore, an Italian law enacted on 19 October 2017 (i.e. *legge delega*) provides for general principles applicable to crisis situations and the insolvency of group companies, even outside the framework of extraordinary administration proceedings. In particular, the *legge delega* sets out the following general principles:

- possible filing with the court of a unique petition for debt restructuring agreements, composition with creditors' proceedings or liquidation regarding the entities in the same group;

- mutual obligations of information and cooperation among the different proceedings of the entities in the same group, being opened either in Italy or in other countries; and

- possible appointment of the same delegated judge, the same judicial commissioner or the same liquidator for the different proceedings of the group entities. The commissioners / liquidators are required to treat each group company individually, but the use of the same commissioners / liquidators would facilitate communication, sharing of information and efficiency.

In cross-border matters, the *legge delega* provides that the Italian insolvency legislation shall be in line not only with the Regulation (EU) 2015/848 on insolvency proceedings dated 20 May 2015 (EIR Recast), but also with the principles of the UNCITRAL Model Law on Cross-Border Insolvency (Model Law), which allows for recognition and cooperation across Europe, and for cases pending in foreign jurisdictions.

In addition to the above and by way of specific implementation of the general principles and guidelines set forth by the *legge delega*, the Italian Legislative Decree No. 14 of 12 January 2019 introduced a brand new Corporate Crisis and Insolvency Code (Code).

After several postponements and amendments, the Code is scheduled to come into effect on 15 July 2022 (except for new early warning system provisions which will enter into force on 31 December 2023). In the framework of the Code, special rules apply in relation to both restructuring remedies, and liquidation proceedings of group companies.[1]

In particular, considering that single and separate proceedings may be prejudicial to the restructuring and recovery of the group, the Code allows the filing of a unique petition for settlement with creditors (or a debt restructuring agreement) on the basis

[1] Code, arts 284-292.

of either a unique plan, or different but related and connected plans (one for each group entity), in order to ensure full cooperation and coordination of proceedings, as well as better satisfaction of creditors' interests.

The general principle of separation of assets and liabilities of each entity of the group still applies under the Code, but it can be mitigated in the event that the plan requires certain acts (including intra-group transfers), provided that an independent expert certifies that such acts are required for the purpose of the business continuity of the group entities and are in line with the objective of a higher distribution to all creditors. Any compensative advantages arising from the participation in the group are also considered in drafting a unique plan and full disclosure of the structure of the group and of the financial statements of each group entities must be provided.

Similar provisions apply in the event of liquidation proceedings involving group entities.

1.1 Corporate group versus individual legal entity

1.1.1 The insolvency and restructuring systems that are in force

Italian law provides for a "group" insolvency process in the framework of *amministrazione straordinaria*, an insolvency proceeding tailored for large insolvent companies.[2]

The concept of group companies adopted in the framework of *amministrazione straordinaria* is the same as described in the Italian Civil Code and is essentially based on direct / indirect control, as well as common direction (discussed further below).

In particular, if the *amministrazione straordinaria* is opened in relation to one of the entities of the group having the relevant dimensional and indebtedness requirements, the insolvency proceedings could be extended to other entities of the same group, provided that: (i) they are insolvent; and (ii) an actual chance of recovery and rebalancing of the economic and financial situation is available, or a unique management of the crisis situation of the whole group is advisable, so as to ensure the aims of the *amministrazione straordinaria* through the economic links existing among the group companies.

In such a case, however, the separate and distinct legal personality of each individual company within the group is respected and the assets and liabilities of the companies are not "pooled" for the purpose of distribution to creditors. In order to put a group of companies into an insolvency process, separate insolvency proceedings must be commenced in respect of each company within the group, as experienced in relation to important cases in Italy (for example, the Parmalat and Alitalia groups). The same commissioners / liquidators are appointed to all entities of the group, while the creditors' committee could be different and integrated from time to time. The expenses and costs of the proceedings are divided among the different entities in proportion to the relevant assets and as such, costs pooling is not allowed.

As noted above, the Code also introduces a set of provisions governing the crisis and insolvency of corporate groups.

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[2] *cfr.* art 81 ff of the Italian Legislative Decree No. 270/1999.

1.1.2 *Definition of a corporate group*

Italian corporate law provides for a definition of "controlling company" and of "controlled company", on the basis of a concept of control which may be different from time to time (i.e. direct vs indirect control; and control through shareholdings vs control through commercial relationships).[3]

The same concept is used in the *amministrazione straordinaria* as a general principle for extending the insolvency proceedings to other entities in the same group, together with the concept of "common direction".

Furthermore, the Italian corporate law provides for a concept of "direction and coordination activity",[4] which is determined only in relation to any relevant corporate abuse. Indeed, the Italian Civil Code does not provide for a definition of "direction and coordination" and the activities of "direction and coordination" must be identified on a case-by-case basis. The exercise of the direction and coordination by the controlling company finds its concrete expression in the effective exercise of a dominant influence on the controlled company. Such dominant influence could be represented, for example, by a steady stream of instructions that the controlling company gives to the controlled company on the management methods, the financing, the budgetary policies, the choice of contracting parties, and so on.

However, article 2497 of the Italian Civil Code provides for a rebuttable presumption, so that it is assumed that direction and coordination exists, in the absence of proof to the contrary, for entities or companies:

- which are required to consolidate their financial statements with that of the company; or

- which control the company according to article 2359 of the Italian Civil Code (i.e. due to ownership of the majority of votes at the ordinary quota holders' meetings of the company, or due to the ownership of votes sufficient to exercise a dominant influence over the company or, finally, due to contractual covenants with the company, capable of determining a dominant influence).

1.1.3 *Legislation relating to corporate groups*

The *legge delega* provides that the relevant provisions of law shall include a group concept based on the definition of "direction and coordination activity".[5] Furthermore, there is the concept of a "group coordination plan" under the EIR Recast (discussed in further detail below).

1.2 Corporate group versus individual corporate benefit

1.2.1 *The existence and relevance of "corporate group benefits"*

Under article 2497 of the Italian Civil Code, an abuse of direction and coordination activity occurs every time the controlling company has given to the controlled

[3] Italian Civil Code, art 2358.
[4] *Idem*, art 2497ff.
[5] *Ibid*.

company instructions conflicting with the subsidiary's interest and / or breaching the company's management principles (intended as the normal standard of care).

Therefore, the controlling company can be held liable at any time (independently from the insolvency of the controlled company) for the debts and obligations of the controlled company and can be required to pay damages where there is an abuse of the direction and coordination activity (a kind of lifting the corporate veil).

The direction and coordination activity of the controlling company can be considered abusive to the extent that, in exercising such activity, the controlling company:

- acted in its own interest or in the interest of a third party;

- breached the rules of the normal standard of care of the company subject to the coordination and direction activity; and

- caused prejudice, as the case may be, to the profitability of the controlled company or to the value of the participation in it (*vis-à-vis* the other shareholders) or to the controlled company's assets (*vis-à-vis* the creditors of the controlled company).

For the purpose of the corporate group benefit, it is important to underline that, in order to verify if the direction and coordination activity has actually caused prejudice as mentioned above, it is necessary to take into account not only each single direction or transaction, but the aggregate result of the direction and coordination activity. Whenever as a matter of fact an economic prejudice to the controlled company was factually restored, or at least balanced, by other benefits or transactions carried out at a group level and aimed at providing advantages to the controlled company, the liability of the controlling company can be reduced or even excluded. The relevant evaluation is made by the court taking into account the factual circumstances of the case at hand.

On that basis, according to the case law of the Italian Supreme Court, there is no breach of direction and coordination rules if the indirect benefits for the company belonging to the group are able to effectively compensate the immediate negative effects of the act carried out at the mother company group level, with either no impact on the creditors' interests, or according to which a positive and final net result of the acts carried out in the interests of the group would allow the court to consider as lawful the single harmful act carried out towards one entity of the group.

1.2.2 Director liability

As a direct effect of their appointment, the directors of a company are entrusted with the general and exclusive duty to manage the company. In particular, in addition to the specific list of duties provided by the Italian Civil Code, the directors have the general duty to carry out the management of the individual company with the care that is required in relation to the office and the characteristics of the relevant company. In order to assess the degree of care that may be expected from each director in the performance of his / her management activity, the functions that the director performs within the company have to also be taken into account.

Directors may not be considered liable for the damages suffered by the company as a result of erroneous and / or non-convenient business choices made during the course of management, *provided that* those choices are part of the range of options which, in the specific case, could be considered as potentially convenient, or anyhow harmless, for the company by a reasonable person having the standard of care and knowledge expected from a director of a company in the relevant business sector. As a matter of fact, although the so-called "business judgment rule" inhibits courts from plunging into the merits of managerial evaluations, courts are not prevented from evaluating whether the decisions of the directors have been taken with clear negligence or reckless disregard and / or with the actual awareness that any decisions made would cause prejudice to the company.

In case of breach of their duties, the directors may be severally and jointly responsible towards:

- the company for the damages connected to the violation of their duties causing prejudice to the company;

- the creditors of the company, for the violation of the obligations concerning the preservation of the "integrity of the company's assets", provided that, as a consequence of the violation, the company's assets have become insufficient to pay the company's creditors; and/or

- individual shareholders or third parties, if the individual shareholder and / or third party has suffered damage that derives "directly" from the negligent or fraudulent action of the director.

The joint liability towards the company does not apply to the directors who: (i) have not been negligent; and (ii) have dissented from the decision of the board causing the prejudice, provided that any dissent has been registered in the books of the board of directors' meetings and has been immediately notified to the president of the statutory auditors' committee (the above conditions are cumulative and not alternative).

The delegation of powers to the managing directors / executive committee does not mean that the non-executive directors are exempted from any duty and from any liability.

In particular, if: (i) the non-executive members negligently do not take care of collecting data or information from the managing directors; or (ii) knew that a detrimental action was being carried out, but they did not impede or limit the consequences thereof, the non-executive members shall be liable jointly with the managing directors / members of the executive committee.

Furthermore, directors may incur criminal liabilities for actions performed before and after a company is declared insolvent, as hereinafter described, and different penalties can apply.

Several of the duties imposed by the law upon the directors of a company are aimed at safeguarding a public interest (specifically, the interest that companies are correctly managed). The violation of those duties triggers criminal liability upon the directors.

Below is a non-exhaustive list of the major crimes which may be committed by directors:

- directors, who, in reports, financial statements or other corporate communications, with the intention of deceiving the shareholders or the public and with the purpose of obtaining an unfair profit for themselves or for others, represent false facts or omit information that has to be communicated regarding the economic and financial situation of the company or of the group to which the company belongs, so that the person / entity to which the information is provided is induced into error;

- directors who, by concealing documents or by any other device, prevent or impede the control or audit activities attributed to the shareholders, to other corporate bodies or to the auditing companies;

- directors who: (i) return equity contributions to the shareholders, or release shareholders from the obligation to pay equity contributions; and (ii) distribute dividends or interim dividends which are fictitious;

- directors who: (i) if not permitted by law, acquire or subscribe shares or quotas of the company, causing damage to the integrity of the capital or reserves of the company which may not be distributed according to the law; (ii) if not permitted by law, acquire or subscribe shares or quotas issued by the controlling company, causing damage to the capital or to the reserves of the company which may not be distributed according to the law; and (iii) also in part, form or increase fictitiously the capital of the company by attributing shares or quotas of the company for an amount in the aggregate higher than the amount of the corporate capital, by mutual subscription of shares or quotas, by significantly overestimating the contributions in kind or of credits or of the capital of the company in the event of transformation; and

- directors who, on the basis of a conflict of interest with the company's interest, dispose or resolve to dispose of company's assets with the aim of procuring an unjust profit or advantage in favour of themselves or third parties, by intentionally causing an economic prejudice to the company.

As far as the voluntary liquidation of the company is concerned, the directors have the duty:

- to verify whether a cause triggering the insolvency of the company has occurred and, in the positive case, proceed accordingly to start the liquidation procedure;

- to carry out the company's management only with the aim at preserving the company's net worth value until the appointment of the liquidators and deliver documents to the liquidators; and

- not to carry out any management activity after the delivery to the liquidators of: (i) the company's books and records; (ii) the financial statements as of the date of the winding up; and (iii) a report on the management until the aforementioned date.

If the directors breach the above-mentioned duties, they will be jointly liable for the damages caused to the company, the shareholders, the creditors and any third parties. In principle, the liabilities of directors above could be challenged also in an insolvency scenario and, in such a case, the relevant legal actions shall be launched by the trustee.

In addition, in case of bankruptcy of the company, the directors are liable if, before the company became insolvent, they:

- carried out any actions for the concealment of assets, the destruction or falsification of accounts and the payment to creditors;
- were negligent in spending or irregularly kept the accounting;
- obtained loans while being aware that the company has serious financial problems; or
- delayed the insolvency declaration, or worsened the financial distress of the company.

In principle, under Italian law, shareholders are not liable for debts and obligations of a controlled company, even if the latter becomes insolvent and, as such, is declared bankrupt or made subject to other insolvency procedures. That is because the general rule under Italian law is that the company has complete financial autonomy, with assets and liabilities entirely separate and distinct from those of its shareholders.

However, there are some limited cases under Italian law, as outlined below, in which the controlling shareholder of a company can be held liable for the debts and obligations of the company.

According to article 2462 of the Italian Civil Code, in the event of the insolvency of a company having a sole shareholder, the latter is jointly responsible with the company for any debts and obligations which arose while it was a sole shareholder provided that either of the following conditions occur:

- the equity contributions owed by the shareholder in favour of the company have not been completed in accordance with article 2464 of the Italian Civil Code; or
- the disclosure in the appropriate Companies Register of the fact that the company has a sole shareholder has not been made as provided for by article 2470 of the Italian Civil Code.

In both cases, the sole shareholder is liable for the company's debts and obligations in the period during which:

- the whole corporate capital of the company was owned by the sole shareholder; and
- the capital contribution and / or the necessary publicity were not completed as prescribed.

1.2.3 "Early warning systems"

No early warning systems exist between directors of individual legal entities and the parent entity. However, there is a general rule of corporate law (applicable to any companies, including group companies) according to which, in case it appears that the corporate share capital of a joint stock company is reduced by an amount higher than one-third as a result of losses, the following procedure shall apply:

- the directors or the management committee – or if they do not act then the board of statutory auditors or the supervisory board – shall call, without delay, the shareholders' meeting in order to take any appropriate action. The expression "without delay" is usually interpreted in the sense that the directors have to call the shareholders' meeting within 30 days from the date on which the directors become aware of the fact that losses have occurred which have reduced the corporate capital by an amount higher than one-third;

- the directors shall prepare and submit to the shareholders interim financial statements for the company, along with the written comments and remarks from the statutory auditors or the control committee. The interim financial statements and the remarks of the auditors shall be filed with the company's registered office during the eight day period preceding the shareholders' meeting; and

- during the shareholders' meeting, the directors shall inform the shareholders about any relevant fact which occurred from the reference date of the above interim financial statements up to the date of the shareholders' meeting.[6]

The main appropriate measures / actions usually adopted by the shareholders are the following:

- reduction of the corporate capital by an amount equal to the amount of the incurred losses;

- restoring of the corporate capital through new contributions by the shareholders aimed at entirely covering the amount of the incurred losses; and

- carry forward of the losses.

As to the carry forward of the losses, if the losses have not been reduced to less than one-third of the corporate capital within the end of the next fiscal year, the shareholders' meeting or the supervisory board, simultaneously with the approval of the relevant financial statements, shall reduce the corporate capital in proportion to the losses that have been ascertained.

In the event of a lack of action by the shareholders' meeting, the directors and the statutory auditors or the supervisory board can file a petition with the court in order to provide for a reduction of the corporate capital to the extent of the losses shown in the financial statements.

In the event that the shares issued by the company are without nominal value, the by-laws can provide that the above-mentioned reduction of the corporate capital be resolved by the board of directors.

For the sake of completeness, when the losses are greater than one-third of the corporate capital and, as a consequence of such losses, the corporate capital of the company is reduced below the minimum threshold required under Italian law for the relevant type of company (e.g. for S.p.A. type of company equal to Euro 50,000), a

[6] Italian Civil Code, art 2446.

different regulation shall apply (e.g. art. 2447 of the Italian Civil Code). In particular, the directors or the management board – or if they do not act then the supervisory board – shall without delay call an extraordinary shareholders' meeting in order to resolve upon:

- the reduction of the corporate capital and the concurrent increase thereof to an amount not lower than the minimum threshold above; or

- the transformation of the company.

1.2.4 *Pending or draft legislation*

There is no exclusive pending or draft legislation in relation to these issues.

The *legge delega* provides a set of remedies available in order to ensure an early dealing with the crisis situation and a quick check of the business continuity – which are now contained in the Code in the form of an Out of Court Early Warning (due to come into effect on 31 December 2023) and Assisted Negotiation Procedure. Those remedies are not provided for exclusively in relation to group companies, but it is important to stress that directors have the duty to make a timely recourse to the restructuring remedies available under the Italian insolvency system.

1.3 Universalism versus territorial principle

1.3.1 *Application of the modified universalism rules*

The Italian courts apply the modified universalism rules as applied by Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings (EIR) and the EIR Recast for any insolvency or restructuring proceedings commenced in a EU member state.

In particular, article 9 of the Italian Bankruptcy Law provides that any insolvency proceedings shall be opened before the court of the place where the company or entrepreneur has its main seat, on the basis of a factual assessment. Any transfer of the registered office which occurred in the one-year term prior to the opening of an insolvency proceeding would not have any effect.

Furthermore, reference is made to both international conventions (such as the Model Law, although it has not been implemented yet in Italy), and to the European Union legislation.

As noted above, the *legge delega* expressly refers to the EIR and the EIR Recast, as well as to the Model Law. Furthermore, it expressly mentions the COMI concept, as defined and interpreted in the European Union legislation.

1.3.2 *Bilateral and / or multilateral treaties in force*

While the European regulations (the EIR and the EIR Recast) are immediately enforceable in the Italian jurisdiction, the Model Law has not been implemented yet.

1.3.3 *Pending legislation*

There is no pending legislation on these issues.

1.4 Competent court and applicable law

1.4.1 Applicable law that falls outside of the lex fori concursus and related issues

In relation to COMI and applicable law, the Italian insolvency law is in line with the European Union law, as well as with the case law of the European Court of Justice.

Where a company's COMI is situated will determine where court proceedings should take place which are then described as the "main" proceedings for the purpose of the EIR. Article 3(1) of the EIR provides a rebuttable presumption that the COMI is located in the place of the company's registered office and it is determined at the time of opening of the proceedings. However, recital 13 of the EIR also provides that a company's COMI should "correspond to the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties". This is very important in order to rebut the presumption that a company's COMI is the place of its registered office.

In relation to the European Court of Justice case law:

- where a debtor is a subsidiary company whose registered office and that of its parent company are situated in two different EU Member States, the presumption laid down in article 3(1) of the EIR, whereby the centre of main interests (COMI) of that subsidiary is situated in the Member State where its registered office is situated, can be rebutted only if factors which are both objective and ascertainable by third parties enable it to be established that the COMI lies elsewhere. That could be so in particular in the case of a company not carrying out any business in the territory of the Member State in which its registered office is situated. By contrast, where a company carries on its business in the territory of the Member State where its registered office is situated, the mere fact that its economic choices are or can be controlled by a parent company in another Member State is not enough to rebut the presumption laid down by the EIR (*Re Eurofood IFSC*);[7]

- a debtor company's COMI must be determined by attaching greater importance to the place of the company's central administration, as may be established by objective factors which are ascertainable by third parties. Where the bodies responsible for the management and supervision of a company are in the same place as its registered office and the management decisions of the company are taken in a manner that is ascertainable by third parties in that place, the presumption cannot be rebutted. Where a company's central administration is not in the same place as its registered office, the presence of the company's assets and the existence of contracts for the financial exploitation of those assets in a Member State other than that in which the registered office is situated cannot be regarded as sufficient factors to rebut the presumption unless a comprehensive assessment of all the relevant factors makes it possible to establish, in a manner that is ascertainable by third parties, that the company's actual centre of management and supervision and of the management of its interests is located in that other Member State (*Interedil*);[8] and

- the EIR is to be interpreted as meaning that, where a company, whose registered office is situated within the territory of a Member State, is subject to an action that

[7] *Re Eurofood IFSC Ltd*, Case C-341/04.

[8] *Interedil Srl in liquidation v Fallimento Interedil Srl and Intesa Gestione Crediti SpA*, Case C-396/09.

> seeks to extend to it the effects of insolvency proceedings opened in another Member State against another company established within the territory of that other Member State, the mere finding that the property of those companies has been intermingled is not sufficient to establish that the COMI of the company concerned by the action is also situated in that other Member State. In order to reverse the presumption, it is necessary that an overall assessment of all the relevant factors allows it to be established, in a manner ascertainable by third parties, that the actual centre of management and supervision of the company is situated in the Member State where the initial insolvency proceedings were opened (*Rastelli*).[9]

Under the EIR, the applicable insolvency law will be that of the Member State within the territory of which such proceedings are opened (the *lex fori concursus*) and the *lex fori concursus* determines the effects of the insolvency proceedings, with some exceptions (including third parties' rights in rem, set-off and reservation of title and employment).

1.4.2 *Harmonisation of substantive restructuring and insolvency laws*

Harmonisation of substantive restructuring and insolvency laws would help in cross-border cases because it would result in better coordination. In many situations, it would be advisable for the affairs of an insolvent group to be managed under a common insolvency regime and a uniform interpretation of rules. Harmonisation could also help in limiting abusive forum shopping practices, resulting in a more certain and predictable legislative framework.

1.4.3 *Applicable treaties and case law*

The relevant treaties and case law are outlined above.

1.4.4 *Upcoming new legislation*

The EIR Recast introduced the concept of a "group coordination plan", as well as a new chapter focused on corporate groups, including a definition of COMI.

Where more than one member of the group is in an insolvency proceeding, the legislation will allow an officeholder to request the opening of group coordination proceedings. A "group of companies" is defined as a parent undertaking and its subsidiary undertakings. The group proceeding is voluntary and officeholders may object to being included as part of the coordination proceedings. Where a company / officeholder has opted in, the officeholder is only required to consider the coordinator's recommendations and the content of the group plan with no obligation on the officeholder to follow the plan, but if an officeholder opts out of the coordination plan, they must provide reasons for opting out. When opening group coordination proceedings, the courts will consider whether any group member might be financially disadvantaged by taking part and whether it is appropriate to proceed with a group plan.

According to the EIR Recast, the COMI is "the place where the debtor conducts the administration of its interests on a regular basis and which is ascertainable by third parties" and "in the case of a company … the place of the registered office shall be

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[9] *Rastelli Davide e C. Snc v Jean-Charles Hidoux*, Case C-191/10.

presumed to be the centre of its main interests in the absence of proof to the contrary." In an effort to reduce forum shopping, the EIR Recast provides that the presumption regarding the registered office shall only apply if the registered office has not been moved to another Member State within the three month period prior to the request for the opening of insolvency proceedings.

2. Substantive consolidated restructuring proceedings versus synthetic group restructurings

With purely domestic groups, it is relatively common to see insolvency practitioners (IPs) act as administrators, commissioners or liquidators for related companies, although it is important to emphasise that the individual creditors and claims are treated on an entity-by-entity basis. That is because the administrators / liquidators are required to look at the group companies as individual entities. Nevertheless, there is a high level of cooperation and coordination, not only in the *amministrazione straordinaria* framework, but also in composition with creditors' proceedings. There is no cost consolidation, although reduced fees are usually payable.

3. Duty to initiate insolvency process

Filing in bankruptcy is a mandatory obligation that rests upon the directors of an individual legal entity. Directors would be liable in the event of a delay in bankruptcy declaration, especially if the delay worsened the economic and financial situation of the company, with prejudice to the creditors' interests. The author is not aware of any legal basis not to open a bankruptcy proceeding or restructuring procedure on the basis that the directors obtained guarantees from an IP in another country.

4. Legal certainty and predictability

4.1 Legal certainty and predictability to local creditors

Because obtaining a guarantee from a foreign IP would not serve as a legal basis not to file for bankruptcy, this issue does not arise in Italy.

4.2 Communications with local courts and creditors

In Italy there is an official publication in the Companies' Register of the opening of any restructuring remedy (except for the restructuring plan, which is usually confidential) and / or insolvency proceedings. In addition, creditors usually receive a notice from the same company or from the administrators / commissioners / liquidators, after the appointment of the same by the court.

4.3 Guarantees by the IP in office

Under Italian law, the company's guarantees are not provided by the IP in the main procedure.

5. Consolidation of assets

5.1 Procedure with respect to the sale of the whole or part of a business

As noted, each legal entity of the group shall be treated as an independent and separate entity. There is no concept in Italian law which permits two companies within the same group to consolidate their assets on the basis of obtaining "joint" creditor approval, and any approval would need to be sought from the relevant creditors of each individual company.

While in composition with creditors proceedings (*concordato preventivo*), creditors are required to vote on the proposal filed by the company and a simple majority is required (with the exception of secured creditors, if they are fully paid, and special rules for classes of creditors), in liquidation processes the sale of assets does not require approval from creditors. In any event, a liquidation plan must receive the favourable opinion of the creditors' committee and by the court.

Shareholders' consent would not be necessary in any of the above-mentioned processes.

5.2 Difference in treatment with respect to tangible and intangible assets

There is no difference in the process for tangible and intangible assets.

5.3 Role of creditors and creditors' committees in a substantive consolidation

As noted, there is no concept of substantive consolidation and each company is treated separately, with separate voting by creditors of each company as a separate and independent entity.

5.4 Voting for or against a substantive consolidation

Not applicable.

6. Equitable distribution and accountability of IPs

Under Italian insolvency law, any reduction of claims, or conversion of debt to equity, is based on a consensual approach. The company may make such a proposal to creditors, and the latter are entitled to vote. The composition with creditors proposal is approved with the favourable vote of creditors representing the majority in value of those entitled to vote. If more classes of creditors are provided in the composition plan and proposal (such as tax authorities, secured creditors, strategic suppliers and non-strategic suppliers), then the majority of classes must vote in favour of the proposal. Secured creditors are not entitled to vote, unless the proceeds of the sale of the assets on which the security is granted are not sufficient for a full payment.

Dissenting minorities can be subjected to cram down. Specifically, following creditors' approval, dissenting creditors and interested third parties (but not shareholders) may challenge the composition with creditors proposal in court on the grounds of its validity. The court may rule against creditors in a dissenting class only if it determines that the creditors' claims will be satisfied at least to the same extent under any other feasible alternative.

7. Intercompany claims

7.1 Order of priority

The presumption exists that the claims of a parent or affiliate company are subordinated, especially in the event these are of a financial nature.

Notably, according to article 2467 of the Italian Civil Code, the repayment to shareholders of any loan granted to the company is subordinated to the prior satisfaction of all other creditors of the company and, if repayment took place in the year preceding the adjudication of the company's bankruptcy, it must be returned to the company.

This applies if, at the time of the granting of the loan, there is an imbalance of the company's indebtedness as compared to its net worth or if, at that time, the financial situation of the company would reasonably have required an equity contribution instead of a loan.

7.2 Concepts that can alter priority

The manner in which equitable subordination applies is set out above.

8. Administering a complex estate in one single consolidated procedure

As noted, there is no concept of substantive consolidation and each company is treated separately.

9. Handling an insolvent parent with a healthy subsidiary

As outlined above, at this stage there is no concept of a group proceeding in Italy, and each legal entity would be treated as a distinct legal entity from the other members of the group.

However, in certain circumstances, solvent subsidiaries may be called upon to contribute to the estate of the insolvent parent if they have provided guarantees for the benefit of the parent or of other affiliates of the group.

MALAYSIA

1. Consolidated group restructurings versus cooperation or coordination procedure

Consolidated group restructurings are not specifically provided for in Malaysia. Malaysian legislation governing the restructuring of legal entities comprises the following:

- the Malaysian Companies Act 2016 (Act);
- the *Pengurusan Danaharta Nasional Berhad Act 1998* (Danaharta Act). The purpose of the Danaharta Act is to provide special laws for the acquisition, management, financing and disposition of assets and liabilities by the Pengurusan Danaharta Nasional Berhad.[1] The Danaharta Act also provides for the appointment of special administrators with powers to administer and manage persons whose assets and liabilities have been acquired by Danaharta Nasional Berhad and related matters; and
- the Malaysia Deposit Insurance Corporation Act 2011 (MDICA). The MDICA was drafted to provide for the continuing existence of the Malaysia Deposit Insurance Corporation and for all matters incidental to or connected with the administration of its powers. The MDICA is relevant to the insolvency of licensed financial institutions in Malaysia.

Restructuring in Malaysia can be done in several ways. The first is through a scheme of arrangement (SOA) under the Act. This is similar to the SOA provisions in the United Kingdom (UK) and Australia. Second, judicial management (JM) can also be utilised as a restructuring option. Third, restructuring can occur via special administration under the Danaharta Act. Finally, restructuring can occur in relation to financial institutions by way of conservatorship under the MDICA. Where the debtors fail to be restructured either formally (as above) or informally, they could then be subject to being wound up either voluntarily or compulsorily by an Order made by the Malaysian High Court (Court).

Separately, the Central Bank of Malaysia established the Corporate Debt Restructuring Committee (CDRC) to provide a platform for a form of mediation between corporate borrowers and their financial institution creditors before resorting to legal proceedings.

- **The Act**

  The previous Companies Act 1965 had already provided for a SOA mechanism. The Act made modifications to the SOA provisions and also introduced what are referred to as "corporate rescue mechanisms". These corporate rescue mechanisms are corporate voluntary arrangements (CVAs) and JM. The three options for distressed companies are briefly explained below.

[1] The Pengurusan Danaharta Nasional Berhad is a public company incorporated under the Companies Act 1965. It is owned by the Minister of Finance of Malaysia. Danaharta was established by the government of Malaysia to act as the national asset management company. Its prime objectives are to re-energise the Malaysian financial sector by buying non-performing loans (NPLs) from financial institutions and maximising their recovery value. By buying NPLs from financial institutions, Danaharta allows them to focus on their core business of lending. A re-energised financial sector promotes confidence which in turn will assist in revitalising the real economy.

- **SOA**

A SOA now falls under sections 366 to 369 of the Act, entitled "Arrangements and Reconstructions". The scheme sets out the mechanism for facilitating a formal compromise, which binds dissenting participants as long as the statutory majority is achieved.

Pursuant to the definition of a "company" under section 365 of the Act, any company liable to be wound up under the Act would be subject to the jurisdiction of the Malaysian courts for the purpose of a SOA. Therefore, the Malaysian courts would have the jurisdiction to allow for a SOA of a foreign company which is liable to be wound up under the Act. While this point has not been decided in Malaysia before, it is likely that the English and Singaporean case law would be persuasive, so that the foreign company would have to show sufficient connection with Malaysia, which can include assets within the jurisdiction.

A SOA allows for a proposal which encompasses the restructuring of one or more companies. The company applies to the court under section 366 of the Act to order a meeting of the creditors, class of creditors, members or class of members. At such a meeting, 75% majority in value of the creditors or members is required for the scheme to be agreed to. The Act introduces the concept of the appointment of a court-approved liquidator to assess the viability of the proposed scheme. Subsequently, a separate application must be made to the court for approval of the agreed scheme. The court may approve, make alterations or impose conditions as it sees fit. However, it is unlikely that the court would take a decision different from the views of the majority creditors.

Under section 368 of the Act, the debtor company may also obtain a restraining order – that is, a moratorium order to stay and restrain legal proceedings against the company. An initial restraining order would last three months and, thereafter, a further application is required for an extension of the period for not more than nine months.

It is possible to file a single set of proceedings which deals with a number of companies in the same group. Nonetheless, the Malaysian courts would still only have jurisdiction to hear the SOA application made by companies which are liable to be wound up under the Act. In other words, the Malaysian courts would only consider a SOA applied for by Malaysian incorporated companies and foreign companies with sufficient connection with Malaysia. The Malaysian courts would not take into account the centre of main interest (COMI) of the companies.

- **JM and CVAs**

The Act introduced the new corporate rescue mechanisms of JM[2] and CVAs.[3] The provisions for these corporate rescue mechanisms came into force on 1 March 2018.

The JM provisions are modelled after the Singapore JM provisions and are akin to the UK administration laws. JM is not available to companies which are essentially licensed or an operator of a designated payment system under the Central Bank of

[2] Act, ss 403-430.
[3] *Idem*, ss 395-402.

Malaysia laws or companies which are subject to the Capital Markets and Services Act 2007. This latter category has been interpreted to mean that public listed companies cannot apply for JM.[4]

The CVA provisions are modelled on the UK's company voluntary arrangement provisions of the Insolvency Act 1986. The CVA allows companies to submit a proposal to their creditors for a voluntary arrangement for restructuring of their debts. An insolvency practitioner (IP) assesses the viability of the CVA proposal, and the company enjoys a limited moratorium on legal proceedings. The process is designed to be fast, cost-effective and with minimal court intervention. Certain companies are specifically excluded from undergoing a CVA, namely a public company, a company which is essentially licensed or an operator of a designated payment system under the Central Bank of Malaysia laws, a company subject to the Capital Markets and Services Act 2007, or a company which creates a charge over its property or any of its undertakings. The later exemption shall result in an exclusion of a wide category of companies being eligible to apply for a CVA.

1.1 Corporate group versus individual legal entity

1.1.1 The insolvency and restructuring systems that are in force

Apart from the concept of a group as explained within the SOA above, the Act does not specifically provide for a group concept for the purposes of insolvency or restructuring. The legislation is moving in the direction of recognising a corporate group, but, as will be discussed further below, this is of limited scope.

In Malaysia, each company is a separate legal entity. Therefore, there is no specific link with regard to restructuring or insolvency between the companies within a group, even where owned by a single legal entity or shareholder.

Areas where the Act does recognise the concept of a group include: situations where accounting periods of companies within the same group are streamlined within two years after the corporation becomes a subsidiary of a holding company;[5] the appointment of a common director for all entities within a group of companies;[6] and consolidation of financial statements with regard to group companies.[7]

1.1.2 Definition of a corporate group

The concept of a "corporate group" has been defined in more recently developed legislation, namely the Financial Services Act 2013 (Act 758) and the Islamic Financial Services Act 2013 (Act 759), as well as in subsidiary legislation, namely the Real Property Gains Tax (Exemption) Order 2015 (P.U. (A) 302/2015) and the Stamp Duty (Exemption) Order 2015 (P.U. (A) 303/2015). The "corporate group" is defined as "a group of corporations which are related to each other".

The Act also provides for a "related corporation". One corporation is deemed to be related to another corporation where: (i) it is the holding company of the other corporation; (ii) it is a subsidiary of the other corporation; or (iii) it is a subsidiary of the

4 See the Malaysian High Court decision of Re Scomi Group Berhad [2022] 7 MLJ 620, but note that this decision is pending appeal before the Court of Appeal.

5 Act, s 247.

6 *Idem*, s 57(2).

7 *Idem*, s 251.

holding company of the other corporation. Once corporations are related to one another, this would bring about certain restrictions and reporting obligations in relation to, for instance, interests in shares, accountability by directors and their shareholdings in related corporations, and loans to persons connected to a director.

Finally, the term "corporate group" has been used in case law to define a group of enterprises. The term has been used when the Court considered lifting the corporate veil where a group of companies seeks to hide behind the advantages of separate legal entities to the disadvantage of their creditors. The Court was of the opinion that, unless there was fraud or where the justice of the case required it, there should be strict compliance with the separate legal entity principle.[8] The concept of separate legal entity remains a strongly held principle and a litigant will find it difficult to "pierce the corporate veil" in circumstances other than fraud.[9]

1.1.3 Legislation relating to corporate groups

There is no draft legislation relating to these issues.

1.2 Corporate group versus individual corporate benefit

1.2.1 The existence and relevance of "corporate group benefits"

The concept of a corporate group benefit is not expressly provided for within the Malaysian legal framework. However, a combination of the Act and the Bursa Malaysia Berhad (Bursa – being the Stock Exchange in Malaysia) Main Market Listing Requirements provide some guidance for the purpose of financial assistance and the granting of guarantees.

Section 213 of the Act allows for companies to give a loan or to guarantee a loan made to a subsidiary or holding company, or a subsidiary of its holding company, in certain circumstances. This is supplemented by the provisions under the Bursa Malaysia Main Market Listing Requirements where, except otherwise provided under the law and subject to certain preconditions, a public listed company may provide financial assistance in certain forms in favour of its associated companies.

On the issue of whether a corporate entity can be held to be a director, section 196 of the Act states that a director must be a "natural person who is at least eighteen years of age". Therefore, a corporate entity may not be able to act as a *de facto* or shadow director of a subsidiary in Malaysia. It is possible that an individual shareholder could be found to be a *de facto* or shadow director of a subsidiary, but this issue has yet to be raised or tested within Malaysia.

1.2.2 Director liability

Sections 213 to 223 of the Act set out the duties and liabilities of the directors of a company. For the purposes of these sections on duties and liabilities, the term "director" would include the chief executive officer, the chief financial officer, the chief operating officer or any other person primarily responsible for the management of the company. The primary duty of a director of the company is to act in good faith and in

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[8] *Mohd Latiff Bin Shah Mord & Ors v Tengku Abdullah Ibni Sultan Abu Bakar & Ors* [2009] MLJU 1246

[9] *Alcatel-Lucent (M) Sdn Bhd (formerly known as Alcatel Network Systems (M) Sdn Bhd) v Solid Investments Ltd and another appeal* [2012] 4 MLJ 72.

the best interests of the individual company itself. This remains true even where the director has been seconded from a parent company to a subsidiary company or where the same director sits on the boards of many of the group's companies – so that the director owes his or her primary duties to that particular company when sitting on its board. This is expressly provided under section 217(1) of the Act. The Act has introduced a new criminal penalty of imprisonment and / or a fine for contravention of various sections with regard to directors' duties.

The Malaysian High Court case of *Lembaga Kemajuan Wang Simpanan Pekerja v Rubfil Sdn Bhd & Ors*[10] revolved around the inclusion of an additional party by way of a third-party notice. Ancillary to the proceedings, for all directors the Malaysian High Court clarified:

> "The directors, be they acted as nominees, sleeping directors or non-active directors they owe a duty of care to assure the company's employees' EPF was protected. As directors of the company, whether as active, nominee, sleeping or non-active directors, all of them are jointly and severally liable."

1.2.3 "Early warning systems"

Malaysian law does not impose statutory "early warning systems" upon officers and directors nominated by a parent company who sit on the board of the subsidiary.

1.2.4 Pending or draft legislation

There is no pending or draft legislation in relation to these issues.

1.3 Universalism versus territorial principle

1.3.1 Application of the modified universalism rules

Malaysia is not party to and has not adopted the United Nations Commission on International Trade Law Model Law on Cross-Border Insolvency (Model Law) and / or any treaties with regard to cross-border insolvency and restructuring. At present there are no plans to adopt the Model Law.

Instead, Malaysia would be able to provide cross-border assistance through the common law route. Common law developments in the UK, Hong Kong and Singapore would be persuasive in Malaysia. Therefore, the principles applicable in case law such as *Singularis Holdings Ltd v Pricewaterhouse Coopers*, wherein the production of information may be applied for subject to certain limitations, would be persuasive.[11]

It is possible for the common law developments on modified universalism to be applied in Malaysia.

However, legislation and development of the common law in Malaysia do not provide for the direct enforcement of a foreign liquidation order. Rather, they provide for limited recognition of the foreign liquidator and the liquidator's powers. Otherwise,

[10] [2005] 7 MLJ 175.
[11] [2014] UKPC 36.

Malaysian laws would apply where the foreign company has been operating within Malaysia and has become insolvent.

1.3.2 *Bilateral and / or multilateral treaties in force*

As noted above, Malaysia is not a party to any treaties in relation to cross-border insolvency and restructuring.

1.3.3 *Pending legislation*

In the near future, the Act is not envisaged to undergo further amendments in terms of adopting cross-border insolvency laws.

1.4 Competent court and applicable law

1.4.1 *Applicable law that falls outside of* **the lex fori concursus** *and related issues*

Pursuant to section 4 of the Act, "Court" under the Act is defined as the Malaysian High Court or a judge thereof.

The sanction of the Malaysian High Court is to be obtained for an SOA. The applicable law is the Act. In line with the Malaysian approach of treating each individual company as its own legal entity, Malaysian law would apply to the restructuring or insolvency proceedings of the company.

The test in *Re Collins & Aikman Corporation Group*[12] (*Collins & Aikman*) focused on the question of the COMI of a company with reference to the European Insolvency Regulation (EIR).[13] The determination of where the company's COMI was situated was important because the EIR and EIR Recast[14] state that the courts of the European Economic Area Member State within the territory of the COMI shall have the jurisdiction to open insolvency proceedings, and the law of the company's COMI will govern insolvency proceedings across the European Union (subject to certain exceptions).

The idea or necessity of a COMI test as expounded in *Collins & Aikman* has not been put forward in Malaysia. However, a Malaysian court may have the power to wind up a company where it is a foreign company with the entirety of its business centralised in the jurisdiction (whether or not it is registered in the jurisdiction).

Specifically, subject to the requirements of section 545 of the Act, a foreign company may be wound up by the court. This remains true even if the company is being wound up, has been dissolved or has otherwise ceased to exist as a company under the laws of the place of its incorporation.

Separately, there is a provision for the law of the place of origin to be applicable where property of a foreign company that has been dissolved remains in Malaysia (except for called and uncalled capital). Otherwise, in line with the individual legal entity treatment of companies, Malaysian law would apply to the procedures

[12] [2005] EWHC 1754 (Ch).
[13] Council Regulation (EC) No 1346/2000 dated 29 May 2000.
[14] Council Regulation (EC) No 1015/848 of 20 May 2015.

undertaken in Malaysia unless specifically provided for by statute and subject to the applicable conflict of law rules of the forum.

Outside of statute, a common law concept exists whereby a court may have the power to wind up a company where it is a foreign company (whether or not it is registered in the jurisdiction) with the entirety of its business in the jurisdiction. This concept has been utilised and successfully argued, for example, in the Singapore case of *Re Griffin Securities Corporation*[15] (persuasive but yet to be positively applied in Malaysia). Where a foreign company is proven to be liable to be wound up, it may also be subject to the jurisdiction of the Malaysian courts for the purpose of a SOA.

The Federal Territory of Labuan in Malaysia has its own separate Labuan Companies Act 1990 (LCA). Companies incorporated under the LCA are akin to offshore companies and enjoy preferential tax treatment. Nonetheless, in summary, companies incorporated under the LCA can also be treated as a company liable to be wound up under the Act. Therefore, companies under the LCA can also utilise the SOA under the Act.

1.4.2 Harmonisation of substantive restructuring and insolvency laws

Although Malaysia has extended its reach to encompass foreign companies in certain circumstances, there is no harmonisation of the laws between the countries, which could lead to a conflict between decisions of the courts in the different jurisdictions.

The harmonisation of substantive restructuring and insolvency laws would assist and smoothen the processes and procedures in cross-border cases, especially in an increasingly globalised world. However, it is difficult to see how this position could be reached in light of the varying stages of advancement of countries' national legislation with specific regard to the regulation of companies and legal entities.

1.4.3 Relevant treaties or case law

These matters are discussed above.

1.4.4 Upcoming new legislation

There is no upcoming new legislation to address these matters.

2. Substantive consolidated restructuring proceedings versus synthetic group restructurings

Informal financial restructuring for distressed companies is available and common under the auspices of the Central Bank of Malaysia's CDRC. However, the CDRC only offers an informal restructuring of debt held by financial institutions. The CDRC provides a platform for debtor companies and financial institution creditors to come to an agreement without having to resort to legal proceedings. The CDRC's Code of Conduct lists the criteria to be met by companies seeking to utilise the CDRC's platform. The CDRC has the absolute discretion to accept or reject cases that do not meet the eligibility criteria. The terms of the Standstill Agreement found within the CDRC Participants' Code of Conduct dated 29 July 2009 are non-negotiable and bind

15 [1999] 3 SLR 346.

all participating creditors. The company concerned is also expected to be viable as a going concern after its passage through the procedure.

However, each step towards the restructuring of a company or group of companies is treated as an individual separate transaction creating a series of transactions resulting in the final intended structure. The current Malaysian legislation on group restructuring is underdeveloped, and therefore restructuring would need to be achieved through the synthetic route as there is no consolidated method.

Nevertheless, the kind of synthetic consolidation which occurred in *Collins & Aikman* is unlikely to be possible in practice as Malaysia has not entered into any bilateral / multilateral treaties for the purpose of restructuring. It is unlikely that Malaysian courts would allow the imposition of a foreign law in a Malaysian court to apply to the distribution of assets of a local or foreign company by local liquidators. Malaysia's recognition of the applicability of foreign law when dealing with assets resides exclusively within section 548 of the Act.

Section 548 of the Act deals with the outstanding Malaysian assets of a *dissolved* unregistered company. Under section 548, such Malaysian assets "shall be and become vested in such person as is entitled according to the law of the place of incorporation or origin of the company …".

Apart from section 548 of the Act, there is no prospective framework in place to allow for such a procedure or recognition of foreign law for the purpose of distribution of assets.

3. Duty to initiate insolvency process

There are no mandatory obligations on directors to commence insolvency or restructuring proceedings in Malaysia. However, under section 540 of the Act, if a company continues to trade (i.e. carry on the business and incur debts when to the knowledge of the directors there is no reasonable prospect of creditors receiving payments for those debts), the directors may be held personally liable for the debts of the company without any limitation of liability. This provision has been increasingly relied on in civil claims filed by creditors or liquidators against directors of a company being wound up.

In addition, section 539(3) of the Act provides for the criminal offence of insolvent trading. The latter provision has rarely, if ever, been utilised in Malaysia.

Although the wording of section 540 of the Act (intent to defraud) conveys the idea of a high standard of proof, in truth the standard of proof is on the balance of probabilities.[16] Therefore, the directors may face the risk of personal liability if they allow the company to continue incurring more debts while insolvent. This may then put pressure on the directors to place the company in some form of voluntary liquidation, rather than to try to restructure or to trade out of insolvency.

Against the above background, if the directors have sufficient basis to believe that the guarantees provided by a foreign IP are genuine, substantial and enforceable, they may not be obliged to commence filing insolvency or restructuring procedures.

[16] *Siow Yoon Keong v H Rosen Engineering Bhd* [2003] 4 MLJ 569.

4. Legal certainty and predictability

4.1 Legal certainty and predictability to local creditors

In line with a director's fiduciary duties and statutory duties under section 213 of the Act, a director should ensure that all due diligence has been undertaken in the best interests of the company.

In light of the comments above, the decision not to place the company into liquidation and to instead accept a guarantee from a foreign IP would not usually be communicated to the creditors. Rather, such a decision would fall under a business judgement taken by the directors with the best interests of the company in mind. The Act protects both the right of a director to make a business judgement as well as the rights of the creditors where directors consciously fail to act in the best interests of the company.

4.2 Communications with local courts and creditors

As indicated above, there would be no express requirement for communication to creditors, nor to local courts.

4.3 Guarantees by the IP in office

There is no general obligation to provide guarantees pending restructuring or liquidation. However, there is an exception in the case of the company requiring the continuation of essential supplies. The Act provides for the situation where the company is under receivership or in JM. Then, the receiver or the judicial manager can seek for the continuation of essential supplies (e.g. water, electricity, gas and telecommunications) by providing a personal guarantee for the debts incurred post-appointment of a receiver or judicial manager.

5. Consolidation of assets

5.1 SOA

In a SOA, as there is no consolidated group procedure for restructuring in Malaysia, each transaction is conducted individually and separately towards the achievement of the final structure. Therefore, a new entity will first have to be set up to receive the sale of the whole or part of the business (where no existing entity exists), and subsequently the transfers of assets or parts of the business shall take place. The procedure is governed by the legislation regulating the relevant asset / industry. Where required either by statute or the company's constitution, the relevant shareholder voting quorums will apply.

For a sale of the assets of a business, a business transfer agreement must cover the sale. Intangible assets are covered by separate statutory transfer forms depending on their nature, and these can be incorporated into the business transfer agreement. Tangible assets are bought and sold via contracts except where compliance with specific legislation is required – for example, a sale of land would require compliance with the National Land Code. A liquidator may do all such things necessary for the distribution of assets of the company, subject to the control of the Court, with any creditor or contributory[17] having the liberty to apply to Court with regard to the liquidator's exercise of powers.[18]

Pursuant to section 366 of the Act, within an arrangement, reconstruction or insolvency, a majority of 75% in value of the creditors or class of creditors present and voting at the court-convened meeting is required to agree to a compromise or arrangement. Where the requisite majority is achieved and the scheme is approved by order of the court, the compromise binds all creditors as well as the company, or where appropriate, the liquidator and contributories.

The Malaysian courts have yet to decide on the issue of at which point the classification of creditors should be determined. The two main approaches are to classify creditors at the stage when leave is granted to convene the meetings of the classes of creditors (the English and Singapore positions), or to classify creditors at the point when court sanction is being sought (the Hong Kong position).

For a SOA, all creditors may vote. To properly classify creditors, a class "must be confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest".

Finally, the flexibility of the SOA would allow the company to choose the creditors with whom it intends to enter into the proposed SOA, to the exclusion of another group of creditors altogether. This remains true even where the company is in the process of being wound up.

A creditor who would not receive a distribution still maintains the right to vote in a scheme. However, as stated above, only 75% in value of the creditors present and voting at the court-convened meeting are required to agree. Therefore, it is unlikely to affect the outcome of the scheme.

5.2 Winding up

Again, Malaysia lacks a structure for sales of assets in a group structure. On an individual basis, wide-ranging powers of a liquidator under Part I of schedule 12 of the Act include the power to:

> "(c) sell the immovable and movable property and things in action of the company by public auction, public tender or private contract with power to transfer the whole immovable and movable property and things to any person or company or to sell the same in parcels."

This schedule consists of powers of the liquidator which are exercisable without the need for approval from the court or from the committee of inspection.

In a winding up scenario, the liquidator would only be considering the company's unsecured debts. Secured debts do not fall within the liquidator's purview.

In the category of unsecured debts, there is also a category of priority debts. After the payment of the costs and expenses of the winding up, there is a list of priority debts

[17] "Contributories" mean persons liable to contribute to the assets of the company when the company is wound up. This term would include the shareholders of the company.
[18] Act, s 486.

that must be paid first before the general unsecured debts. This list of priority debts includes certain wages or salaries and workers' compensation, contributions to the employees' social security contributions, and federal tax.

Pursuant to section 525 of the Act, unsecured creditors must prove their debt by way of an affidavit and bear any costs of such proof unless otherwise ordered by the court. Unsecured creditors are entitled to review and examine other creditors' proofs and deduct from their debt all trade discounts (subject to certain criteria).

The rights of secured creditors are codified in section 524 of the Act. Secured creditors have three options upon the winding-up of a company:

- to realise a property subject to charge (where entitled);
- to value the property subject to charge and claim as an unsecured creditor for any balance due; or
- to surrender the charge to the liquidator for the benefit of creditors and claim in winding-up as an unsecured creditor for the full debt.

5.3 Receivership

Section 383, together with schedule 6, of the Act sets out the minimum powers of a receiver or receiver and manager (R&M). Sections 2(a) and 2(b) of schedule 6 of the Act set out the power of the receiver and R&M to take possession and control of the company's property in accordance with the order or instrument for appointment of the receiver or R&M, as well as to dispose of the property of the company.

A receiver or R&M must carry out their duties to realise the company's assets and distribute its proceeds in satisfaction of the charged debts owed to the debenture holder and subsequently return any surplus assets to the company. These duties are subject to the following:

- a duty to act in good faith;
- a duty to exercise reasonable care in obtaining the proper price; and
- if opting to continue with the business, the receiver or R&M must take reasonable steps to manage the business profitably.

A fixed charge is the most secure collateral in the list of creditors under receivership. A floating charge would be subject to the payment of certain preferential debts in priority above the floating charge debenture holder. After the costs and expenses of the receiver or the R&M, the preferential debts are then essentially the wages or salaries of the employees and contributions due by the company as an employer.

A receiver or R&M does not owe any duty to the unsecured creditors of a company.

6. Equitable distribution and accountability of IPs

Section 366 of the Act governs the requirements of a compromise between a company and its creditors. All that is required is for 75% in value of all the creditors or a specific class of creditors to agree to a compromise or arrangement. This compromise or arrangement will then need to be sanctioned by the Court. Therefore, the SOA does allow for such a cram down within the class of creditors, but Malaysia does not have cross-class cram down provisions.

In a debt-for-equity swap scenario, the issuance of shares will require prior approval of the other shareholders by way of a resolution by the company together with any applicable provisions in any company's constitution and / or any shareholders' agreement. Quorum restrictions will depend on the requirements in the company's constitution. Companies must be vigilant of contravening the prohibition on financial assistance. Public listed companies must comply with the requirements pursuant to the company's articles, shareholders' agreement and any requirements under the Act, Capital Markets and Services Act 2007 and Bursa Malaysia Listing Requirements for the board to issue new shares.

7. Intercompany claims

The parent or affiliate a company's claims would rank *pari passu* with the claims of other creditors in light of the prevailing position being that each company is a separate legal entity.

It is sometimes common for parent or affiliate companies to structure shareholder loans or provide funding to subsidiaries or related companies through instruments such as redeemable convertible preference shares. These would provide the option of converting the preference shares to ordinary shares and to therefore take on a larger equity stake in the company.

8. Administering a complex estate in one single consolidated procedure

Each company within a corporate group is handled separately and individually on the basis that each company is in itself its own corporate legal entity. Administration of consolidated groups, or sub-groups, is therefore not possible in Malaysia.

9. Handling an insolvent parent with a healthy subsidiary

In Malaysia, a healthy subsidiary is unlikely to be affected by an insolvent parent due to the fact that each company is a separate legal entity. Therefore, the healthy subsidiary should be fully capable of maintaining its viability in the event the parent company is insolvent.

SINGAPORE

1. Consolidated group restructurings versus cooperation or coordination procedure

Insolvency proceedings are usually dealt with on an entity level and there are at present no formal mechanisms for consolidated group restructurings under Singapore law. There is also no requirement for members of a corporate group to proceed under the same type of insolvency proceedings.

There are three main types of insolvency proceedings under Singapore law. These are:

- **Liquidation**

  Where an insolvent company is dissolved and its existence is terminated after its assets are realised for the benefit of creditors;

- **Judicial management**

  Where an insolvent company is placed under the management of a judicial manager (appointed by the court or creditors) with a view to rehabilitate the company's business or at least carry out a more advantageous realisation of the company's assets than would otherwise occur in liquidation; or

- **Schemes of arrangement**

  A restructuring tool which allows a company to come to a binding compromise with its creditors. The Singapore scheme of arrangement is broadly similar to the United Kingdom scheme of arrangement. The Singapore scheme of arrangement provisions, found in section 210 of the Companies Act 1967 (Companies Act), were adapted from section 206 of the former United Kingdom Companies Act 1948, which is now Part 26 of the Companies Act 2006, as well as section 181 of the former Australian Companies Act 1961, which is now Part 5.1 of the Corporations Act 2001. The other relevant provisions relating to a Singapore scheme of arrangement can be found at Part 5 of the Insolvency, Restructuring and Dissolution Act 2018 (IRDA).

Further, with effect from 29 January 2021, the Insolvency, Restructuring and Dissolution (Amendment) Act 2020 amended the IRDA to establish the Simplified Insolvency Programme (SIP). The SIP consists of both a Simplified Debt Restructuring Programme (SDRP) and a Simplified Winding Up Programme (SWUP).

The intention of the SIP is to provide simpler, faster and lower-cost insolvency processes for micro and small companies (MSCs), being those incorporated in Singapore with annual sales turnover not exceeding S $10 million, no more than 30 employees, no more than 50 creditors and liabilities not exceeding S $2 million (and unencumbered assets not exceeding S $50,000 for the SWUP).

In relation to the SDRP, this is essentially adapted from the existing pre-packaged scheme of arrangement under the IRDA. It requires only a single court application, and provides for an enforcement moratorium once a company is accepted into the SDRP, so that the company has time to devise a restructuring plan to submit to creditors. Importantly, the approval threshold for a restructuring plan under the SDRP is only two thirds in value (with no requirement for a majority in number), as opposed to the 75% in value (and majority in number) required for a scheme of arrangement.

The SIP is currently only applicable until 28 July 2022, pursuant to the Insolvency, Restructuring and Dissolution (Extension of Prescribed Periods for Parts 5A and 10A) Order 2021, although this may be extended by further Order in future.

However, because it is intended to be used for simple matters in the case of MSCs, the SIP will generally not be appropriate in the case of a corporate group insolvency context.

While there is no overarching substantive law for a consolidated group restructuring in Singapore, there is to some extent coordination of the restructuring process from a procedural perspective (this is discussed below).

1.1 Corporate group versus individual legal entity

As noted, Singapore law generally does not recognise an overarching concept of insolvency proceedings for a corporate group. Each company is treated as a separate legal entity and separate insolvency proceedings must be filed for each company.

However, where restructuring of a corporate group is underway, Singapore law does recognise the advantages of coordinating restructuring proceedings of separate legal entities within a corporate group. Recent changes have been made to the law to this effect, such that where a company pursuing a scheme of arrangement has been granted a statutory moratorium on claims against it, its subsidiaries, holding company or ultimate holding company can separately apply to the court for a similar statutory moratorium under section 65 of the IRDA. Each legal entity within the corporate group can, in this way, be adequately protected throughout the duration of the group restructuring process. As it is a fairly new provision, however, there is currently no case law on section 65 of the IRDA.

1.2 Corporate group versus individual corporate benefit

1.2.1 The existence and relevance of "corporate group benefits"

While the concept of corporate group benefit is recognised under Singapore corporate law, directors owe their duties primarily to each of their respective companies, not the group as a whole. In other words, directors, especially those of a holding company, may consider the interests of a group so long as they do not sacrifice the interests of any company within the group to which they are appointed.[1] To this extent, any transfer of assets or provision of upstream guarantees, for example, may therefore be carried out within the group, but only if it is consistent with the interests of the individual company that is transferring the assets or providing the guarantee.

1.2.2 Director liability

Singapore law provides for corporate governance mechanisms that would apply to members of a corporate group transferring assets or providing upstream guarantees to one another. Shareholder approval must be obtained for a disposal of the undertaking or substantially the whole of the undertaking of the company to another company within the corporate group pursuant to section 160 of the Companies Act. A shareholder who is a director of the holding company should be careful in voting to

[1] *Intraco Limited v Multi-Pak Singapore Pte Ltd* [1995] 1 SLR 313.

dispose of substantially the whole of the undertaking of a subsidiary in which he or she is also acting as a director because there is a potential for conflict between the interests of holding company and its subsidiary. In such a scenario, given that the director would owe fiduciary duties to both the holding company and its subsidiary, the director should abstain from voting if he or she is unable to adequately manage that conflict.

Further, a shareholder of the holding company might be considered a "shadow director" of the company or its subsidiaries. This would include a shareholder who, notwithstanding the fact that he or she is not formally appointed as a director, provides directions and instructions upon which the directors or the majority of directors of a corporation are accustomed to act.[2] If the directors of all the group companies are the same, there is a potential for conflict between the interests of each group entity. The directors will need to manage their duty to each group entity, including by considering whether the transaction is in the interests of each individual company that is transferring the assets or providing the guarantee.

Directors can also be liable for wrongful trading pursuant to section 239 of the IRDA by causing a debt to be incurred knowing that there was no reasonable prospect that the company would be able to pay the debt, as well as fraudulent trading pursuant to section 239 of the IRDA.

Furthermore, the transfer of assets or provision of any upstream guarantee, for example, cannot occur at an undervalue or it may amount to an unfair preference (that is, the transfer cannot put the transferee in a better position than he or she would otherwise have been in when the company was placed in a winding up).[3] If the company is found to be in contravention of the relevant statutory provisions, any transfer or other act relating to property would be void or voidable in the same manner as in the liquidation of a company.

1.2.3 "Early warning systems"

There are no early warning systems required to be in place between directors of individual entities and the parent entity under Singapore law.

1.2.4 Pending or draft legislation

There is no pending or draft legislation on these issues.

1.3 Universalism versus territorial principle

1.3.1 Application of the modified universalism rules

The IRDA incorporates the UNCITRAL Model Law on Cross-Border Insolvency (Model Law), which is based on the principles of modified universalism. Singapore has since also abolished the statutory requirement that the assets of a local subsidiary to an international corporate group are to be ring-fenced for local creditors. Singapore therefore remains committed to the principles of cooperation and coordination when dealing with cases of cross-border insolvency, while respecting the substantive insolvency laws of other foreign states.

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2 Companies Act, s 4.
3 IRDA, ss 224-225.

1.3.2 Bilateral and / or multilateral treaties in force

There are no relevant treaties on these matters.

1.3.3 Pending legislation

There is no pending legislation on these matters.

1.4 Competent court and applicable law

1.4.1 Applicable law that falls outside of the lex fori concursus *and related issues*

As Singapore has adopted the Model Law, the Singapore courts will, subject to public policy exceptions, recognise foreign proceedings as:[4]

- a foreign main proceeding if it is taking place in the state where the debtor has its centre of main interests (COMI); or

- a foreign non-main proceeding if a debtor has in that foreign state any property or any place of operations where the debtor carries out a non-transitory economic activity with human means and property or services (see article 2(d) of the Model Law).

In applying the COMI test, there will be a preliminary presumption that the debtor's COMI is located where it has its registered office. Such a presumption may be rebutted by clear objective and ascertainable evidence to the contrary that the COMI is in another foreign jurisdiction.[5]

Any foreign representative appointed in a foreign main or non-main proceeding may apply to the Singapore courts for recognition of the foreign proceedings in which the foreign representative has been appointed.[6]

In a similar effort to explore and develop comity in cross-border restructuring and insolvency proceedings, the Singapore court in *Pacific Andes Resources Development* (*Pacific Andes*)[7] had also considered the rule in *Antony Gibbs & Sons v La Société Industrielle et Commerciale des Métaux (Gibbs),*[8] which provides that a discharge of debt is not effective unless in accordance with the law governing the debt. In summary, the Singapore court in *Pacific Andes* observed that the *Gibbs* formulation is territorial in perspective and a reformulation of the principle in *Gibbs* would be an important and timely step in the global insolvency landscape as it may otherwise prove to be an impediment to "good forum shopping" *(Pacific Andes* at [51]).

As the Singapore court in *Pacific Andes* was not required to rule on the issue, the position in Singapore law remains open. However, the Singapore court has observed in *obiter* that where the court has subject matter jurisdiction and there are assets located in, or a sufficient nexus to, the jurisdiction that warrants the exercise of

[4] Model Law, art 17.
[5] Model Law, art 16(3); *Opti-medix (in liquidation)* [2016] SGHC 108, [26].
[6] Model Law, art 15.
[7] *Pacific Andes Resources Development* [2016] SGHC 210.
[8] *Antony Gibbs & Sons v La Société Industrielle et Commerciale des Métaux* [1890] LR 25 QBD 399.

jurisdiction, debts which are not governed by Singapore law may now nevertheless be legitimately discharged by a local scheme of arrangement.[9]

As to the question what falls outside of the *lex fori*, the Singapore rules of private international law would be applied to determine which law is applicable to the validity and effectiveness of a right or claim and their treatment in insolvency proceedings.

In determining the applicable law as to the validity and effectiveness of a substantive right or claim, the Singapore courts will generally apply common law principles to determine which substantive category of choice of law it belongs to (for example, contracts, torts and restitution).

As to the treatment of the right or claim in insolvency proceedings, the *lex fori concursus* will generally govern the commencement, conduct, administration and conclusion of these proceedings.

There are exceptions to the application of the *lex fori concursus* under Singapore law. For example, Division 4 (Insolvency) of the Securities and Futures Act (Cap. 289) of Singapore (SFA) provides an exception to the application of the *lex fori concursus* to payment or settlement system-related contracts. Section 81C provides that *inter alia* market contracts or other contracts effected by approved or recognised clearing houses will not be impacted by any inconsistency with the Singapore law of insolvency. Such contracts will instead be governed by the business rules of the approved or recognised clearing house. Section 81L also provides that a Singapore court shall not recognise or give effect to: (i) an order of a court exercising jurisdiction under the law of insolvency in any place outside Singapore; or (ii) an act of a person appointed in any place outside Singapore to perform a function under the law of insolvency in that place, insofar as the making of that recognition order by a court in Singapore, or the doing of the act by a relevant office holder, would be prohibited under the SFA.

In relation to securities interests held in book-entry form at the Central Depository (Pte) Ltd (CDP), the clearing and depository house of Singapore, section 81SR of the SFA states that provisions of any written law in relation to *inter alia* company liquidation providing that the avoidance of any disposition of the property of a company after commencement of a winding up will generally not apply to any disposition of book-entry securities. If a Singapore court is however satisfied that the party to the disposition (other than the CDP) had notice that a winding-up application had been made in respect of the other party to the disposition, it may award damages against that party or make such order as the court thinks fit. This could include an order for the party to the disposition to transfer the book-entry securities but not an order for the rectification of the CDP's register.

There is no exception under Singapore law with respect to application of the *lex fori concursus* to the registration of charges and priorities of security interests in insolvency proceedings,[10] so that the law governing the registration of charges and the priorities of security interests in insolvency proceedings must be determined by the law of the country where the winding up is commenced, even if the law governing the validity or creation of that interest is that of another jurisdiction.

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[9] *Pacific Andes*, [52].

[10] Singapore High Court decision in *Duncan, Cameron Lindsay & Anor v Diablo Fortune Inc and another matter* [2017] SGHC 172, [31].

1.4.2 *Harmonisation of substantive restructuring and insolvency laws*

The difficulties with global harmonisation of restructuring and insolvency laws are well acknowledged. National insolvency regimes are often underpinned by different policy considerations, which manifest in differences to the structure and content of the relevant insolvency laws. Nevertheless, there are limited areas where harmonisation might be desirable, such as a common test of insolvency as well as certain procedural aspects of the restructuring process. Incremental development in this area could significantly facilitate cross-border restructuring processes in the future.

1.4.3 *Relevant treaties or case law*

These matters are outlined above.

1.4.4 *Upcoming new legislation*

There is no upcoming new legislation on these issues.

2. Substantive consolidated restructuring proceedings versus synthetic group restructurings

While there is no overarching substantive law for a consolidated restructuring of a group, there is to some extent a degree of coordination of group restructuring processes from a procedural perspective.

Singapore law permits the administration of related companies by a single administrator and there is usually no hearing just to decide the appropriateness of the appointment of a single administrator for each corporate entity. The same single administrator can likewise be nominated to be administrator for each and every entity in a particular corporate family group. Other professional advisors such as legal counsel may also be appointed across a corporate group, subject to any conflict of interest in accepting an appointment for more than one company in the group.

As mentioned above, where a company pursuing a scheme of arrangement has been granted a statutory moratorium, Singapore law now allows subsidiaries as well as holding companies of that company to apply for a stay of proceedings, which better facilitates the restructuring effort on a corporate group level.

3. Duty to initiate insolvency process

Although there is no express duty on a company to commence insolvency such as a filing in bankruptcy or restructuring proceedings at any particular time, directors of an insolvent company are subject to various rules and duties that would incentivise them to commence insolvency or restructuring proceedings in order to avoid the consequences of failing to comply with such rules. Some of these rules include the following provisions:

- a director or other officer of a company may be responsible for fraudulent trading pursuant to section 238 of the IRDA (previously section 340 of the Companies Act), or wrongful trading pursuant to section 239 of the IRDA, if it appears that any business of the company had been carried on with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose, or it appears that the company had traded wrongfully; and

- a director's fiduciary duty to act in the company's best interests will, when the company is insolvent or near insolvent, also include taking into account the interests of its creditors as a whole. While creditors may not sue the director for a breach of this duty, the company acting through its liquidators may do so.

There is no firm legal basis for directors not to open a bankruptcy proceeding or restructuring procedure on the basis that the directors obtained guarantees from an insolvency practitioner (IP) in another country. This is also not a common practice in Singapore.

Ultimately, the question to ask with respect to a company near or in insolvency is whether the guarantee serves as adequate protection to the company and its creditors as a whole. To succeed on such a basis is a fact sensitive exercise. Much will depend on: (i) the quantum of the guarantee and the extent to which it covers the company's liabilities; and (ii) the quality of the guarantee and in particular, the creditworthiness of the IP and whether any funds have been ring-fenced for the purpose of servicing the foreign IP's guarantee.

4. Legal certainty and predictability

As noted, there is no blanket provision under Singapore law which authorises directors to decline to commence insolvency proceedings on the basis that they have received guarantees from a foreign IP. There are also no express rules governing the level of disclosure or lines of communication that should be established with local courts and creditors if such a course of action is taken. The guiding principle is that the directors must ensure that the course of action taken is in the best interests of the company. Hence, if the guarantees from the IP in another country are taken, it will be the directors' responsibility to ensure the adequacy of the quantum and the quality of the guarantee provided by the foreign IP, as well as the levels of publicity or lines of communication with the company or creditors.

5. Consolidation of assets

5.1 Procedure with respect to the sale of the whole or part of a business

Singapore does not recognise automatic pooling of assets or liabilities of various members of a corporate group in the context of a restructuring or insolvency. This type of pooling can only be done if all relevant creditors of all affected entities agree, or if the requisite majority (75% in value and 50% in number)[11] of each of the entities agree to the pooling of assets or liabilities under a scheme of arrangement.

Under a scheme of arrangement, different types of creditors will be placed in separate classes for the purpose of voting if the scheme varies their legal rights in such a dissimilar way so as to make it impossible for these creditors to consult together with a view to their common interest.[12] The statutory majority must be achieved across all classes of creditors. With respect to creditors who are associated or related to the entity, they have the same voting rights as ordinary creditors at the creditors' meeting. However, the court, when it subsequently sanctions the scheme, will have the discretion to discount these votes to ensure that the votes of that class of creditors are

[11] Companies Act, s 210(3AB).
[12] *The Royal Bank of Scotland NV (formerly known as ABN Amro Bank NV) v TT International Limited* [2012] SGCA 9.

objectively represented.[13] Creditors or stakeholders whose financial interests are immaterial (meaning that they are no worse off whether under the restructuring or liquidation) may also be disregarded by the court.[14] Some examples include ordinary shareholders[15] or subordinated creditors.[16]

Further, the court has the power to cram down on a dissenting class of creditors when it subsequently sanctions the scheme pursuant to section 70 of the IRDA. Where the court exercises this power, there are certain statutory protections if the dissenting class of creditors is unsecured. The scheme of arrangement: (i) must provide for each creditor in that dissenting class to be repaid in full; or (ii) must not provide for any creditor with a subordinate claim to a dissenting class or a shareholder to receive or retain any property on account of their respective claims pursuant to section 70(4)(b)(ii) of the IRDA (previously section 211H(4)(b)(ii) of the Companies Act).

5.2 Difference in treatment with respect to tangible and intangible assets

There is no relevant difference in treatment for tangible and intangible assets.

5.3 Role ofcreditors and creditors' committees in a substantive consolidation

The creditors' role in voting on a scheme is set out above.

5.4 Voting for or against a substantive consolidation

This could only occur in accordance with the voting under a scheme of arrangement outlined above.

6. Equitable distribution and accountability of IPs

There is no general statutory bail-in mechanism if the proceeds of a restructuring or liquidation are insufficient. Any subordination of debt would be a matter of contractual arrangements between the company and its creditors.

As noted above, in the context of a scheme of arrangement, before the court exercises its power to cram down on a dissenting class of creditors, it must be satisfied that if that dissenting class is not repaid in full, creditors with subordinate claims and shareholders do not receive or retain any property under the scheme on account of their claims.[17]

7. Intercompany claims

Under Singapore law, each company within the corporate group has a distinct personality. Claims by one member of the corporate group against other members are *prima facie* valid and enforceable and will therefore rank *pari passu* with other unsecured creditors. There is no automatic subordination of group debt unless agreed otherwise between these companies.

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[13] *Idem*, [155]; see also *SK Engineering & Construction Co Ltd v Conchubar Aromatics Ltd and another appeal* [2017] 2 SLR 898.
[14] *Bluebrook Limited* [2009] EWHC 2114 (Ch), [25].
[15] *Tea Corporation* [1904] 1 Ch 12.
[16] *MyTravel Group plc* [2004] EWHC 2741.
[17] IRDA, s 70(4).

However, in the context of voting in a scheme of arrangement, intercompany claims will usually be classed separately from other unsecured creditors or have their votes discounted.

8. Administering a complex estate in one single consolidated procedure

This question does not arise as consolidated group restructurings are not available in Singapore.

9. Handling an insolvent parent with a healthy subsidiary

As each company within the corporate group has a distinct legal personality, such an arrangement would only be possible under a scheme of arrangement.

SOUTH AFRICA

1. Consolidated group restructuring versus cooperation or coordination procedure

1.1 Corporate group versus individual legal entity

1.1.1 The insolvency and restructuring systems that are in force

In South Africa, the law relating to corporate insolvency and restructuring is principally governed by the following pieces of legislation:

- the Insolvency Act, 24 of 1936 (Insolvency Act);
- the Companies Act, 61 of 1973 (1973 Companies Act);
- the Companies Act, 71 of 2008 (2008 Companies Act); and
- the Close Corporations Act, 69 of 1984 (Close Corporations Act).

Prior to the promulgation of the 2008 Companies Act, which came into effect on 1 May 2011, the fate of financially distressed entities was either liquidation or judicial management.

Judicial management was in large part a failure as a result of various factors, including the costs associated with the process, the inability to raise finance for the distressed entity and the absence of an effective mechanism to restructure companies' debts. Therefore, the vast majority of financially distressed entities were liquidated.

▪ **Business rescue**

One of the main purposes of the 2008 Companies Act was to provide for the efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders.[1] In line with this purpose, chapter 6 of the 2008 Companies Act brought the novel concept of business rescue into the law.

"Business rescue" is defined in section 128(1)(b) as proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for:

- the temporary supervision of the company, and of the management of its affairs, business and property;
- a temporary moratorium on the rights of claimants against the company or in respect of property in its possession; and
- the development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities and equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, if that is not possible, results in a better return for the company's various stakeholders than would result from the immediate liquidation of the company.

[1] 2008 Companies Act, s 7(k).

Business rescue can be commenced by way of a resolution passed by the board of directors or by way of an application to court by an affected person, being a shareholder, employee or creditor. A court application is mandatory where liquidation proceedings are pending against the debtor company.[2]

In order to commence business rescue proceedings, a company has to be financially distressed and there also has to be a reasonable prospect of rescuing the company.

"Financially distressed",[3] in relation to a particular company at any particular time, means that:

- it appears to be reasonably unlikely that the company will be able to pay all of its debts as they become due and payable within the immediately ensuing six months; or

- it appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months.

A business rescue practitioner (BRP) is appointed by the company with full control and supervision of the company in rescue. It is the BRP's duty to develop a business rescue plan and publish it within 25 business days. This time period can be extended as long as it is supported by the majority of independent creditors' voting interests. The creditors and shareholders, insofar as it affects their rights, consider and vote on the business rescue plan. In order for the plan to be adopted, at least 75% of the creditors' voting interests have to support it, and these votes must include at least 50% of the independent creditors' voting interests. At least 50% of the shareholders' voting interests have to support the plan should the plan affect their rights.

An adopted business rescue plan is binding on all affected persons whether or not they voted in favour thereof. This allows for the cram down of dissenting minority creditors and shareholders.

- **Liquidation**

South African liquidation laws are outdated and in serious need of reform. The 2008 Companies Act does not completely repeal the 1973 Companies Act in that liquidations of insolvent companies are still governed by Chapter 14 (sections 337 to 426) of the 1973 Companies Act – which is applicable to companies whose liabilities exceed its assets, and to companies which are unable to pay their debts as and when they fall due for payment.[4] In terms of section 339 of the 1973 Companies Act, the provisions of the 1973 Companies Act must be read with the provisions of the Insolvency Act. The Close Corporations Act contains similar provisions for the winding-up of close corporations.

These Acts provide for the appointment of a liquidator to take over the affairs of the company and also set out the process of winding-up, including but not limited to powers and duties of the liquidator, the process for proving claims, convening

[2] *Idem*, s 129(2)(a).
[3] *Idem*, s 128(1)(f).
[4] *Boschpoort Ondernemings (Pty) Ltd v ABSA Bank Ltd* 2014 (2) SA 518 (SCA).

meetings of creditors, treatment of executory contracts, treatment of secured, preferred and concurrent creditors and timeframes for the final winding up of the insolvent estate. The Acts further make provision for the setting aside of impeachable dispositions and set-offs and other provisions applicable to transactions that might have taken place prior to the commencement of liquidation proceedings.

- **Section 155 compromise with creditors**

  Section 155 is available to any company, irrespective of whether it is financially distressed, unless it is already engaged in business rescue proceedings.

  The board of a company, or the liquidator if the company is being wound up, may propose an arrangement or a compromise of the company's financial obligations to all of its creditors by delivering a copy of the proposal and notice of the meeting to consider the proposal to all creditors or to those creditors of a particular class which shall be affected.

  The proposal must contain all information reasonably required by creditors in deciding whether or not to accept or reject the proposal and must be divided into three parts: background, proposals and assumptions and conditions as set out in section 155(3). The content of the proposal is substantially the same as that required of a business rescue plan.

  Similar to the adoption of a business rescue plan, the proposal will be deemed to have been adopted if a majority of creditors representing more than 75% of the creditors' voting interests vote in favour thereof.

  Once adopted, the company may apply to court to have the proposal sanctioned.

- **Informal workouts**

  Informal workouts, like elsewhere in the world, are possible in South Africa. However, as a result of the absence of an enforcement moratorium, they are not very popular and in general quite often result in formal insolvency proceedings. This is as a result of various factors, including:

  - South African insolvency proceedings, save for the business rescue provisions in the 2008 Companies Act, are still predominantly a creditor-driven process;

  - the general economic environment and the general mindset of creditors is predominantly one that favours the rights of creditors rather than a debtor-friendly environment which favours rescue and rehabilitation of the debtor;

  - the rights of individual creditors and access to court for the initiation of liquidation proceedings has a very low threshold: a creditor may apply for a winding up order for a debt of more than ZAR100 (one hundred rand) and the process to initiate winding up proceedings by creditors is a simple and speedy remedy as opposed to other forms of collection proceedings available to creditors; and

  - if a debtor makes or offers to make any arrangement with any of its creditors for releasing the debtor wholly or partially from its debts, this constitutes an act of insolvency which triggers grounds for initiation of insolvency proceedings by a creditor.[5]

However, it is common that debtors facing financial distress will engage their financiers and secured lenders for informal workouts prior to formal insolvency proceedings, as opposed to engaging the body of creditors as a whole.

- **Assessment of South African insolvency and restructuring legislation**

Since its implementation on 1 May 2011, the introduction of business rescue legislation has had a radical impact on the South African insolvency landscape, as it introduced the concept of rescue and rehabilitation of debtor companies with a simplified procedure for the commencement of insolvency proceedings by the debtor with the insolvency practitioner (IP) – in this case the BRP – being nominated by the debtor.

The restructuring of insolvent companies through business rescue proceedings has since secured its place in South African corporate insolvency law, with greater instances of rescue and rehabilitation of financially distressed companies. This in turn has brought about greater confidence in the process for both debtors and creditors alike and provides a platform for much needed change in the mindset of all the players within the South African corporate environment. However, when compared to insolvency proceedings in developed countries in Europe and the United States, it is clear there is still room for much improvement, especially in the fields of cross-border insolvency and the treatment of multinational enterprises and companies falling within broader group structures.

As will be detailed in this chapter, there is no insolvency and restructuring legislation specifically applicable to groups of companies, as current legislation only deals with single legal entities rather than corporate groups.

1.1.2 Definition of a corporate group

- *South African company law*

In terms of section 1 of the 2008 Companies Act, a group of companies is defined as a holding company and all of its subsidiaries.

A "holding company" is defined in section 1 as, in relation to a subsidiary, a juristic person that controls that subsidiary as a result of any circumstances contemplated in section 2(2)(a)[6] or section 3(1)(a).[7]

Section 2 of the 2008 Companies Act defines related and interrelated persons and control. Natural persons are related if they are married, or live together in a similar relationship, or are separated by no more than two degrees of consanguinity. A natural person is related to a legal person if the individual indirectly or directly controls the legal person. A legal person is related to another legal person if either of them directly or indirectly controls the other, either of them is a subsidiary of the other, or a person directly or indirectly controls each of them.

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[5] *Insolvency Act*, s 8(e).
[6] Related and interrelated persons, and control.
[7] Subsidiary relationships.

"Control" is defined in section 2(2) of the 2008 Companies Act. A person, natural or legal, is deemed to control a legal person if that legal person is a subsidiary of the first person, or if the person is directly or indirectly able to exercise the majority of voting rights in respect of securities or has the right to appoint directors who control the majority of votes at a meeting of the board.

According to Botha,[8] in relation to the 1973 Companies Act, the basic characteristic of the holding / subsidiary relationship of a group of companies is that the management of the different and independent companies comprising the group is coordinated in such a way that they are managed on a central and unified basis in the interests of the group as a whole. This management on a unified basis is possible because of the control, implicit in the holding / subsidiary company relationship, which the holding company exercises over the subsidiary or subsidiaries. This control makes it possible for the group to be managed as an economic unit, in the sense that the different holding and subsidiary companies no longer carry out their commercial activities on a footing of complete economic independence. As was the case in the 1973 Companies Act, the definition of the holding / subsidiary relationship is meant to be exhaustive.

The 2008 Companies Act provides further control provisions which are specifically related to groups of companies, *inter alia:*[9]

- group and consolidated financial statements are required for a group of companies;[10]

- the auditor of a holding company has the right to access all current and former financial statements of any subsidiary of that holding company and is entitled to require from the directors or officers of the holding company or subsidiary any information and explanations in connection with any such statements and in connection with the accounting records, books and documents of the subsidiary as necessary for the performance of the auditor's duties;[11] and

- the annual financial statements of a company must include a report by the directors with respect to the state of affairs, the business and profit or loss of the company, or of the group of companies, if the company is part of a group.[12]

However, while the 2008 Companies Act acknowledges the concept of a group and provides for the inclusion of the control provisions referred to above, this does not amount to a denial of the separate legal personalities of the companies involved in the group.

Indeed, while the South African courts have often referred to a group[13] of companies, they have emphasised that:

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8 DH Botha, "Recognition of the Group Concept in Company Law" (1982) 15 *De Jure* 107, 108.

9 R Jooste et al, *Contemporary Company Law* (2nd edn, Juta, 2017) 195

10 2008 Companies Act, s 30, read with the definition of "financial statement" in s 1.

11 *Idem*, s 93(1)(b).

12 *Idem*, s 30(3)(b).

13 See *Hull v Turf Mines* 1906 TS 68, 77; *Robinson v Randfontein Estates Gold Mining Co Ltd* 1921 AD 168, 196; *R v Milne and Erleigh* (7) 1951 (1) SA 791 (A), 810–812, 827–828; *Goode, Durrant & Murray Ltd v Hewitt & Cornell NNO* 1961 (4) SA 286 (N), 291; *S v Heller* 9 (2) 1964 (1) SA 524 (W), 525, 527, 533–535; *Langeberg Koöperasie Bpk v Inverdoorn Farming & Trading Co Ltd* 1965 (2) SA 567 (A), 603, 604, 606; *S v de Jager* 1965 (2) SA 616 (A), 619. See also Jooste et al (see n 9 above).

- the group is not a separate independent *persona* apart from the *personae* of the independent constituent companies comprising the group;[14] and

- there is no separate *persona* which represents the interest of the different companies in a group that exists side by side with the *personae* of the different companies in a group.[15]

The Appellate Division in *Ritz Hotel Ltd vs Charles of the Ritz Ltd* (*Ritz*)[16] stated that the acts of a holding company are not *per se* the acts of its wholly owned subsidiary, or *vice versa*, since the holding company is a separate legal entity from its subsidiary. That a group of companies effectively forms one economic unit does not mean that the separate identity of each company has to be ignored and that the group has to be treated as one entity.[17]

In the context of impeachable dispositions, where a company, which is one of a group of companies, has by way of a suretyship furnished security by way of a mortgage or pledge of the company's assets to secure the liabilities of another company or other companies within the group, the disposition may be a disposition for which the company has received value in the form of continued financial stability of all the companies in the group, which is a benefit with some ascertainable commercial advantage for itself.[18]

By way of exception to the above, the court may "pierce the corporate veil" by treating the liabilities of the company as those of its shareholders or directors and disregarding the corporate personality of the company. Piercing the corporate veil is not a remedy which the courts resort to easily, as the concept of separate legal personality has been entrenched in the law from the early English decision of *Salomon v Salomon and Co Ltd*[19] and the Appellate Division decision in *Dadoo Ltd v Krugersdorp Municipal Council.*[20]

In *Ex Parte Gore and Others NNO* (*Gore*),[21] the learned judge summed up the historical context and acknowledged the trend during the 1960s and 1970s of the courts showing a willingness to ignore the separate personality of individual companies in a group context in reference to *Ritz* but stated that the more recent conservative trend by the English courts has been endorsed in subsequent South African judgments. He stated further the judicial philosophy that the separate personality of legal persons should be disregarded only in exceptional

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[14] Jooste et al (see n 9 above); Botha (see n 8 above), 111. See also *R v Milne and Erleigh*, 827, 828; *Goode, Durrant & Murray Ltd v Hewitt & Cornell*; *Langeberg Koöperasie Bpk v Inverdoorn Farming & Trading Co Ltd*, 606-607; *Harold Holdsworth & Co (Wakefield) Ltd v Caddies* (1955) 1 A11 ER 725, 734; *Charterbridge Corporation Ltd v Lloyds Bank Ltd* (1970) Ch 62, 74; *Lonrho Ltd v Shell Petroleum* (CA) (1980) 2 WLR 367, 374–375; *The Albazero* (1975) 3 A11 ER 21 (CA); and the Australian decisions *Walker v Wimborne* (1976) 50 ALJR 446, 449 and *Industrial Equity Ltd v Blackburn* (1978) 52 ALJR 89, 93.

[15] See *R v Milne and Erleigh*, 827-H. See also *Langeberg Koöperasie Bpk v Inverdoorn Farming & Trading Co*, 606E–G

[16] 1988 (3) SA 290 (A).

[17] *Wambach v Maizecor Industries (Edms) Bpk* 1993 (2) SA 669 (A) and *Macadamia Finance Bpk v De Wet* 1993 (2) SA 743 (A).

[18] Meskin et al, *Insolvency Law and its Operation in Winding-Up* (LexisNexis), 5-102; *Langeberg Kooperasie BPK v Inverdoorn Farming and Trading Company* 1965 (2) SA 597; *Rousseau and Others NNO v Visser and Another* 1989 (2) SA 289.

[19] (1897) AC 22 (HL).

[20] 1920 AD 530.

[21] 2013 (3SA382) (WCC) at [27].

circumstances and as a last resort under the common law, as has been articulated in some recent South African judgments.[22]

Accordingly, save where the wording or purpose of a particular statute or contract justifies the treatment of a holding company and a subsidiary as one corporate entity, the mere fact that the group of companies constitutes a single economic unit does not in itself justify the treatment of the group as a single entity. The position may be different where the subsidiary is a façade or a sham.

In *Gore*, the court further relied on section 20(9) the 2008 Companies Act (as a basis for statutory veil piercing), which states:

> "If, on application by an interested person or in any proceedings in which a company is involved, a court finds that the incorporation of the company, any use of the company, or any act by or on behalf of the company, constitutes an unconscionable abuse of the juristic personality of the company as a separate entity, the court may—
>
> (a) declare that the company is to be deemed not to be a juristic person in respect of any right, obligation or liability for the company or of a shareholder of the company or, in the case of a non-profit company, a member of the company, or of another person specified in the declaration; and
>
> (b) make any further order the court considers appropriate to give effect to a declaration contemplated in paragraph (a)."

The court, on request of the liquidators of a number of companies which formed part of the "King group of companies", had to determine whether the corporate veil could be lifted and if so, what should the treatment be of the claimants and / or investors in respect of the various companies forming part of the group.

It was held that, although the courts enjoy no general discretion to look behind the corporate veil merely because it would be just and equitable, the courts would look behind the separate legal personality of a company where justice requires it, and not only when there is no alternative remedy.

Fraud or other improper conduct has generally been present in the cases in which the veil has been lifted or pierced. A policy-based decision is required in each case to disregard a company's separate legal personality. To achieve this, a determination must be made having regard to the material, practical and legal considerations which underpin the legal fiction of separate juristic personality measured against the adverse moral and economic effects of an unconscionable abuse of the concept by directors and / or shareholders.

In the end, the court held that the various King companies shall be regarded as a single entity by ignoring their separate legal existence and treating the holding company, King Financial Holdings Ltd, as if it were the only company. The order further provided that, in respect of all of the various subsidiaries (all of which were

[22] See *F Hülse-Reutter v Gödde* 2001(4) SA 1336 and *Airport Cold Storage (Pty) Ltd v Ebrahim and others* 2008(2) SA 303.

in liquidation), after payment of all liquidation costs, bond holders' claims and claims other than investors' claims, their assets were to be transferred to the liquidators of King Financial Holdings to be administered as a single pool of assets available for distribution to the investors.

- *Insolvency and restructuring legislation*

  There are no provisions relating to groups of companies in any of the insolvency or restructuring provisions of the various Acts relating to the winding up or restructuring of companies. The bulk of the jurisprudence and case law in respect of insolvency cases principally relates to the existence of fraud and the piercing of the corporate veil, referred to above.

  Therefore, while the concept of a group of companies is entrenched in South African law, the laws governing insolvency and business rescue are only concerned with a single legal entity and have no automatic application to all entities in a group of companies under the control of one holding company or one entrepreneur.

1.1.3 Legislation relating to corporate groups

There are no further draft company or insolvency laws which provide for the group concept.

1.2 Corporate group versus individual corporate benefit

1.2.1 The existence and relevance of "corporate group benefits"

South African corporate law not only acknowledges the need for and the existence of group structures, it goes further to acknowledge that group structures commonly provide commercial, financial and organisational advantages for the group as a whole.[23]

An example of legislative recognition of the corporate group benefit can be found in sections 41 to 47 of the Revenue Laws Amended Bill 2002, which were introduced in order to neutralise a group restructuring for tax purposes where the companies involved form part of the same group of companies. These provisions are applicable to any restructuring, both outside of formal insolvency proceeding and in respect of formal insolvency proceedings. Prior to the 2002 amendments, any disposal of assets between two group companies or a merger or an amalgamation between companies within the same group would result in normal income tax and capital gains tax implications for the restructuring transactions concluded. These corporate roll-over relief provisions enable a group of companies to structure their group in the most efficient way without being subjected to material tax implications.

1.2.2 Director liability

Sections 76(3)(a) and 76(3)(b) of the 2008 Companies Act state that, subject to sections 76(4) and 76(5), a director of a company, when acting in that capacity, must exercise the powers and perform the functions of director:

[23] D Bhana "The Company Law Implications of Conferring a Power on a Subsidiary to Acquire the Shares of its Holding Company" (2006) 17 *Stell LR* 233.

- in good faith and for a proper purpose; and
- in the best interests of the company.

While this wording removes any doubts that the directors of a company owe their duties to the company and the duties are consequently enforceable by the company, it should be noted that the fiduciary duties of directors have been developed in South Africa since the eighteenth and nineteenth centuries, mainly based on English Law. Thus, the statutory codification of the duties set out above is not intended to be an exhaustive or comprehensive codification of the fiduciary duties of directors and regard must be had to the common law position. At common law, the word "company" in this context refers not to the legal entity itself, but rather to the interest of the collective body of present and future shareholders.[24]

That said, in relation to the common law position in respect of directors of a subsidiary, the fiduciary duty is not owed to the holding company of the subsidiary, or to the group of companies of which the subsidiary forms a part.[25]

However, section 76(2) of the 2008 Companies Act has modified the common law principle and provides:

> "A director of a company must–
>
> Not use the position of director, or any information obtained while acting in the capacity of a director–
>
> - to gain an advantage for the director, or for another person other than the company or a wholly-owned subsidiary of the company; or
> - to knowingly cause harm to the company or a subsidiary of the company."

The inclusion of a subsidiary represents an important extension of the common law principles. According to the common law, a director of a holding company does not owe any fiduciary duty to its subsidiary as each company in a group of companies is regarded as a separate legal entity. This section accordingly imposes a duty on directors not to misuse their positions as directors or not to use information obtained as directors to knowingly cause harm to a subsidiary of the company.[26]

- *King III Report*

  In addition to the above, the King Report on Governance for South Africa 2009 (King III Report) and the King Code of Governance for South Africa 2009 (Code) apply to all entities incorporated in and resident in South Africa and set out a number of key corporate governance principles and best practice recommendations on how to carry out each principle. In South Africa, compliance with the King III Report and the Code is mandatory for companies listed on the Johannesburg Stock Exchange, but, for all other entities, there is no statutory

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[24] FHI Cassim et al, *Contemporary Company Law* (Juta 2012) 12.2.4; JE Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (Oxford University Press, 1993) 76-77; *Greenhalgh v Ardene Cinemas Ltd* (1951) Ch 286, 291.

[25] *Charterbridge Corporation Ltd v Lloyds Bank Ltd* (1969) 2 A11 ER 1185; *Lindgren v L & P Estates Co Ltd* (1968) A11 ER 917.

[26] Cassim et al (see n 24 above), 551.

obligation to comply with the King III Report and the Code. However, the courts do occasionally take corporate governance practices into account.[27]

The King III Report provides that a holding company must recognise and respect the fiduciary duties of the directors of the subsidiary company and particularly the duty to act in the best interests of the subsidiary company at all times, whether or not the director has been nominated to the board of the subsidiary company by the holding company.[28] Further, it is acceptable for the chairperson or chief executive officer of a subsidiary company to be appointed as a director on the holding company's board, but emphasises that the fiduciary duties of the director are owed to the company to which he or she has been appointed.[29]

The King III Report further recommends that a governance framework be agreed upon between a group and the boards of its subsidiaries.[30]

The implementation and adoption of policies, processes or procedures of the holding company in the operations of the subsidiary company should be considered and approved by the subsidiary company if the subsidiary company board deems it appropriate.[31] The subsidiary company should disclose this adoption and implementation in its integrated report.[32]

1.2.3 *"Early warning systems"*

In the 2008 Companies Act, section 129(7) is of importance for the diligent director of a company in financial distress. The test for financial distress is a forward-looking test that encompasses commercial as well as factual insolvency. In terms of section 129(7), if the board of a company has reasonable grounds to believe that the company is financially distressed, but the board has not passed a resolution to place the company into business rescue, the board must deliver a written notice to all creditors, employees and shareholders setting out the grounds of financial distress and the reasons why the board has elected not to place the company into business rescue. Directors expose themselves to personal liability if they do not act in terms of section 129(7). Therefore, in theory, section 129(7) is the ultimate early warning mechanism for affected persons. However, in practice, we have seen very few, if any, directors notifying affected persons in terms of this section.

Section 4 of the 2008 Companies Act is also of particular importance for the diligent director. This section sets out the "solvency and liquidity test" that should be satisfied under the Act. A company satisfies the solvency and liquidity test at a particular time if, considering all reasonably foreseeable financial circumstances of the company at that time, the assets of the company, as fairly valued, equal or exceed the liabilities of the company, as fairly valued; and it appears that the company will be able to pay its debts as they become due in the ordinary course of business for a period of 12 months. This is a forward-looking test over 12 months, as opposed to the six-month forward-looking test for financial distress. When financial assistance is intended to be

[27] *South African Broadcasting Corporation Ltd v Mpofu* (2009) 4 ALL SA 169 (GSJ) and *Minister of Water Affairs and Forestry v Stilfontein Gold Mining Co Ltd* 2006 (5) SA 333 (W).
[28] King III Report, [142].
[29] *Idem*, [144].
[30] *Idem*, principle 2.24
[31] *Idem*, [145].
[32] *Ibid.*

provided within a group structure, the solvency and liquidity test must be satisfied, or directors expose themselves to personal liability.

Directors should also be cognisant of the reckless and fraudulent trading provisions in South African law.[33] These provisions serve as a deterrent to the diligent director to continue trading when the company is financially distressed. Should directors fail to file for business rescue and continue trading in insolvent circumstances, they expose themselves to personal liability.[34]

Save as provided above, no further provisions are applicable for early notifications in respect of the Companies Act relating to the financial distress of a company.

1.2.4 Pending or draft legislation

There is no pending draft legislation presently under consideration in respect of the 2008 Companies Act. It is, however, envisaged that the 2008 Companies Act is due for an update and a General Amendment Act has been proposed by several scholars.

1.3 Universalism versus territorial principle

1.3.1 Application of the modified universalism rules

Cross border insolvencies in South Africa are currently regulated by the common law (general law) and judicial precedent, which allows a South African High Court to recognise the appointment of a foreign representative on the basis of comity, convenience and equity. The principles of private international law (conflict of laws) will also be applied, especially with regard to the treatment of property situated in this jurisdiction.[35] South African courts follow an approach that incorporates aspects of both the universal and territorial approaches to cross-border insolvency. In line with the universalist approach, South African courts are willing to cooperate with and assist foreign insolvency representatives in cross-border matters. However, despite the fact that the court is willing to cooperate with foreign representatives, it does not do so without protecting local creditors. The latter is a characteristic of the territorial approach. According to Fourie,[36] the strong emphasis placed on the protection of local creditors indicates that the South African common law approach leans predominantly towards the territorial approach to cross-border insolvencies.

According to South African law, foreign trustees are automatically vested with the insolvent person's movable property, in whatever jurisdiction it might be situated if, at the date of the granting of the insolvency order, the insolvent was domiciled in the area of the jurisdiction of the court that granted the order. Immovable property is administered according to the *lex rei sitae* – the law of the place where the property is situated. Accordingly, the sequestration of an estate outside South Africa does not divest the insolvent of immovable property situated in South Africa.[37] Practically, however, when dealing with movable and immovable property situated in South

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[33] 1973 Companies Act, s 424; 2008 Companies Act, s 22.
[34] *William Leitch Bros Ltd* [1937] All ER 892 at 895.
[35] A Boraine, "Elements of Bankruptcy Law and Business Rescue in South Africa" (unpublished note, 2015).
[36] EG Fourie, "'n Vergelyking van die Oorgrens Insolvensie Wetgewing van Suid Afrika" (unpublished dissertation 2012) 31.
[37] M Olivier and A Boraine, "Some Aspects of International Law in South African Cross Border Insolvency" 38(3) *Comparative and International Law Journal of Southern Africa* 373–395.

Africa, a foreign trustee is still required to seek recognition by the South African High Court before being able to deal with the property. *In Ward v Suit*,[38] the court held that it is imperative for the foreign representative of a legal person to apply for recognition where he or she has to deal with either immovable or movable property within South Africa.

After recognition has been obtained, the foreign representative may deal with local assets. The South African court may impose conditions on the foreign representative in order to safeguard the rights and interests of local creditors. The recognition order serves as a secondary procedure to the existing foreign bankruptcy order. The granting of such recognition order is within the local court's discretion, but recognition is usually granted in the interests of comity and convenience. In exercising their discretion, territoriality remains largely the norm applied by the South African courts, and the recognition order usually makes provision for, *inter alia*, notice to interested parties, general powers of the foreign representative and procedural aspects, and will always provide some protection for the interests of local creditors.[39]

Some courts have expressed a preference for a single forum of administration where the main proceeding is directed by *forum domicilii*.[40] However, if an application for recognition fails or if it is not applied for, foreign creditors may always apply for the opening of a local procedure in terms of local law.[41]

In the case of a South African winding up order where a local representative seeks to recover assets that are situated in a foreign jurisdiction (outbound request), the laws and procedures of the foreign jurisdiction must be complied with. The foreign law will therefore dictate the legal position for the South African representative in this regard.

1.3.2 Bilateral and / or multilateral treaties in force

South Africa has no cross-border insolvency treaties or international convention with any other country. The common law position is based upon judicial precedent.

1.3.3 Pending legislation

The South African Cross-Border Insolvency Act 42 of 2000 (CBIA) came into force in November 2003 and follows the United Nations Commission on International Trade Law Model Law on Cross-Border Insolvency (Model Law). Section (2)(a) of the CBIA provides that the CBIA "applies in respect of any state designated by the Minister of Justice by notice in the government gazette." Section(2)(b) of the CBIA goes on to state:

> "The Minister may only designate a state as contemplated in paragraph (a) if he or she is satisfied that the recognition accorded by the law of such a state to proceedings under the laws of the republic relating to insolvency justifies the application of this act to foreign proceedings in such a state."

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[38] 1998 (3) SA175 (SCA).

[39] A Boraine, *Cross Border Insolvency II: A Guide to Recognition and Enforcement* (INSOL International, 2012), Chapter 38 "South Africa".

[40] *Ex parte Palmer NO: In re Hahn* 1993 (SA) 359.

[41] *William Leitch Bros Ltd* [1937] All ER 892; Meskin et al (see above, n 18), 17-5.

This provision implies reciprocity, in that the law of the foreign state accords to the same kind of treatment as the South African insolvency proceedings before designating a foreign state under this section, which would allow the foreign representative of that foreign state to use the CBIA. However, the Minister of Justice has not to date designated any state in accordance with these provisions. Accordingly, despite South Africa having been one of the first countries to adopt the Model Law, for all practical purposes the CBIA remains stillborn.

The CBIA will come into force when the Minister of Justice designates the states to which the Act would apply. Once designated, the Act would take effect in terms of those states only. Accordingly, in the future it is envisaged that South Africa will follow a dualistic approach to cross-border insolvency matters. The rights and responsibilities of foreign representatives and foreign creditors from designated states will be governed by the procedures set out in the CBIA, while the position of the representatives from non-designated states will be governed by the common law. Thus, for designated member states where the CBIA finds application, the principle of modified universalism similar to the EIR Recast will apply.

The High Court is designated as the only court with the necessary jurisdiction to hear cross-border insolvency matters, and the CBIA provides a quicker, less complicated procedure for the foreign representative to obtain recognition and provisional relief where required.

Recognition in terms of the CBIA is of a mandatory nature, rather than in the courts' discretion as in the case of the common law approach. If the foreign representative applies for the recognition of foreign proceedings that are taking place in the state where the debtor has its centre of main interest (COMI), the High Court must recognise the proceedings as foreign main proceedings and, if application is made in terms of a foreign proceeding taking place in a state where the debtor has an establishment as defined by the CBIA, the court must recognise the foreign proceedings as foreign non-main proceedings.[42]

After recognition is granted, the foreign representative is entitled to deal with the debtor's South African based property, and the CBIA further provides for equal treatment for all creditors, both local and foreign. The foreign representative is also granted the right to commence local insolvency proceedings in terms of the laws of the Republic of South Africa as if he or she were appointed as such by a domestic court.[43] Insolvency proceedings in the Republic of South Africa may only be commenced if the debtor has assets in South Africa, and, in such a case, the local proceedings are restricted to the debtor's assets in South Africa. The CBIA further promotes cooperation between the courts and foreign courts or foreign representatives, either directly or through a trustee, liquidator, judicial manager, curator or receiver.[44] Courts may communicate and seek information or help directly from foreign courts or representatives and, with the High Court's supervision, local representatives are expected to act in a similar fashion. In addition, section 26 of the CBIA grants them the same right of direct communication with foreign courts and representatives.[45]

[42] CBIA, ss 17(2)(a), 17(2)(b).
[43] *Idem*, s 11.
[44] *Idem*, s 22.
[45] *Idem*, s 27.

1.4 Competent court and applicable law

1.4.1 Applicable law that falls outside of the **lex fori concursus** *and related issues*

In the case of winding up of insolvent companies, the 1973 Companies Act provides that the High Court of South Africa, where the company has its registered office or main place of business in South Africa, would have jurisdiction over the winding up proceedings of the company.

In terms of section 339 of the 1973 Companies Act, the provisions of the Insolvency Act apply to the winding up of companies. However, its applicability only commences once the company is in the process of being wound up (after the granting of the winding up order).

Therefore, the 1973 Companies Act, rather than the Insolvency Act, governs the jurisdiction of the court in terms of insolvent companies. In *Sibakhulu Construction (Pty) Ltd v Wedgewood Village Golf Country Estate*[46] and *First Rand Bank Ltd, Wesbank Division v PMG Motors Alberton (Pty) Ltd (In Liquidation)*,[47] the court concluded that, as section 12(1) of the 1973 Companies Act had been repealed, and there was no equivalent provision in the 2008 Companies Act, jurisdiction fell to be determined on common law grounds. The court found that for purposes of jurisdiction relating to a change of status of company, a local company resided only at its registered office, which must be the same as its principal office in terms of the 2008 Companies Act. Therefore, it is the High Court, having territorial jurisdiction in respect of an application for winding up a company or placing a company under supervision for business rescue purposes, that is the court where the company's registered office is located.[48] In respect of proceedings instituted after the granting of a winding up order, the ordinary rules of jurisdiction apply. Accordingly, the fact that a company has been liquidated does not mean that it can no longer be said to reside at its principal place of business, and therefore the jurisdiction of a court arising from the location of its principal place of business is unaffected by its liquidation.[49]

Solvent companies may be wound up by resolution or on application to court in accordance with the provisions of the 2008 Companies Act,[50] and the court having jurisdiction over such applications is the court where the company is registered, having regard to the provisions of section 23(3) of the Act which require the registered office of a company to be the same as its principal office.

For the purpose of South African corporate insolvency law, South Africa follows the separate entity approach, and accordingly each juristic entity within a group of companies will be dealt with separately. Winding up proceedings in respect of each individual entity fall within the jurisdiction of the High Court of the company's registered address or principal place of business and are administered by the Master of the High Court of the same jurisdiction. Local laws will be applicable to the winding up of each entity.

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[46] 2013 (1) 191 WCC.
[47] 2013 (4) All SA 117 (GSJ).
[48] Meskin et al (see above, n 18) 1-4.
[49] *Ibid*. See also *PMG Motors Kyalami (Pty) Ltd and Another v First Rand Bank Ltd, Wesbank Division* 2015 (2) SA 634 (SCA), [13].
[50] 2008 Companies Act, ss 79, 80, 81.

In the case of cross-border insolvency where recognition is obtained by a foreign representative in accordance with the common law, recognition is based on comity, convenience and equity. The Supreme Court of Appeal in *Lagoon Beach Hotel v Lehane*[51] recently reconfirmed the common law position that the nature of the property in question should be considered, and, in the case of movable property, a formal application for the recognition of the foreign trustee is not strictly necessary. However, such an application is invariably made, and the need for formal recognition has been elevated into a principle.

As indicated above, the position with regard to immovable property is such that the property is governed by the *lex situs*. The trustee must first be granted judicial recognition in South Africa before he or she can deal with any immovable property of the insolvent debtor situated in this country. The granting of recognition to a foreign trustee to deal with an insolvent's immovable property in South Africa is a matter for the local court's discretion. This discretion is absolute and is exercised on the basis of comity and convenience.

1.4.2 Harmonisation of substantive restructuring and insolvency laws

The nature of the multinational business enterprise is such that the modern business conglomerate has various economic units forming part of a larger consolidated integrated economic unit which expands over multiple jurisdictions, and the possibilities of failures and insolvencies of multinational enterprises have created a need for harmonisation of substantive restructuring and insolvency laws.

Different juridical frameworks pose various difficulties and challenges in the case of highly integrated group insolvencies. While the business may be a single business unit, the laws addressing insolvency are local and national. So too is the array of diverse attitudes, rights and obligations of the various stakeholders. While some legislative frameworks might support rescue and rehabilitation of financially distressed entities, others could be more in favour of creditor-driven procedures and processes. Valuable lessons may be learned from a number of high-profile multinational insolvencies over the past decade, and in particular the fact that the best result for all stakeholders is more likely to be achieved where the enterprise group could be restructured and / or continued in operation and possibly sold as a going concern. However, such an option may not be viable where the applicable domestic laws lean towards liquidation rather than rescue.

1.4.3 Applicable treaties and case law

South Africa is not a party to any treaties on cross-border issues. However, proposals have been made for a Southern African treaty based on the content of the Model Law. The Model Law may serve as an inspiration when negotiating transnational insolvency regimes in the region. Proposals have been made for such an agreement within the South African Development Community.[52]

From a case law perspective, South African business rescue proceedings have been given outbound recognition under Chapter 15 of the US Bankruptcy Act by the United States Bankruptcy Court, Southern District of New York in respect of *In re: Comair (in*

[51] 235/2015 SCA 210.
[52] Olivier and Boraine (see above, n 37).

Business Rescue), Debtor in a Foreign Proceeding.[53] There, the Court ordered that South African business rescue proceedings were to be recognised as a foreign main proceeding and it granted an automatic stay of all claims lodged against Comair in the United States.[54] South African compromise proceedings in terms of s 155 have further been recognised as foreign main proceedings in *In Re Edcon Holdings Ltd*[55] and *In re Cell C Proprietary Ltd*.[56] The recognition of South African insolvency proceedings by foreign courts is relevant to a South African Court's determination and recognition of foreign proceedings in terms of comity.

1.4.4 Upcoming new legislation

An unofficial Draft Insolvency and Business Recovery Bill dated 30 June 2010, which was further updated in 2013, has been completed by the Department of Justice. It is not clear when this new piece of legislation will be taken forward by government, but Item 9 of Schedule 5 of the 2008 Companies Act envisages the introduction of such new legislation. This Bill is an effort to codify the existing corporate, insolvency and restructuring legislation currently found in various different Acts into one unified Act. The substance and form of the legislative provisions, however, do not provide significant changes to the current applicable legislation.

2. Substantive consolidated restructuring proceedings versus synthetic group restructurings

The current corporate insolvency legislation does not provide for consolidated group proceedings and, having regard to the current common law position in respect of cross-border insolvencies, synthetic consolidated restructurings as achieved by the *Collins and Aikman*[57] case and that of *Nortel Networks*[58] are not possible in South Africa. The following legal and practical obstacles exist:

- the absence of designated states or designated member states in the current CBIA, which means that South African courts will follow a territorial approach to cross-border insolvencies; and

- the absence of a framework for cooperation between South African courts and foreign courts and foreign representatives and local IPs.

Both the South African common law position and the position after the designation of member states allow the opening of secondary proceedings according to local laws. Secondary proceedings are not mandated to be liquidation or winding up proceedings. Accordingly, the foreign representative or the foreign creditor, as the case may be, may apply for business rescue proceedings through the High Court, which, once initiated, will allow for the stay of execution while granting the debtor company the ability to reorganise its debt and / or propose the consolidated sale of its assets subject to the adoption of a business rescue plan.

These proceedings will allow for the provision of post-commencement finance[59] for

[53] Case No: 21-10298 (JLG), the United States Bankruptcy Court, S.D New York.
[54] Para I of Order Granting Relief in Aid of a Foreign Main Proceeding.
[55] Case No 16-13475 (SCC) (Bank SDNY Jan 19, 2017).
[56] Case No: 571 BR 542 (Bank SDNY 2017).
[57] *Re Collins and Aikman Europe SA* [2006] EWHC 1343.
[58] *Re Nortel Networks SA* [2009] EWHC 206.
[59] 2008 Companies Act, s 135.

the continuation of trading operations and will allow the IP in conjunction with the locally appointed BRP sufficient opportunity to come to an arrangement with local creditors or classes of local creditors. These proceedings will, however, be limited to local assets of the debtor and will be subject to the business rescue plan being adopted. Procedural coordination of proceedings and proposals to creditors may be achieved through the adoption of a business rescue plan, subject to achieving the required threshold of votes in support of the plan. It is also possible to convert final liquidation proceedings into business rescue proceedings.[60] Business rescue proceedings are, however, limited to companies as defined in section 1 of the 2008 Companies Act, and are therefore not applicable to secondary proceedings relating to foreign companies with a local establishment or local assets only. In the case of the latter, recognition of foreign proceedings will be dealt with by the courts on the basis of territoriality, as discussed above.

3. Duty to initiate insolvency process

As outlined above, the case of a company facing financial distress, provision is made in the 2008 Companies Act for directors to notify all affected stakeholders of the nature of the company's distress and the reasons why the board has elected not to place the company into business rescue.

The directors, by virtue of the notice referred to in section 129(7), are able to avoid attracting personal liability, and creditors and other affected parties are thereby afforded the opportunity to evaluate for themselves whether or not to consider the various options in respect of their relationship with the company. It should be noted, however, that, while this provides a platform for creditors to engage with the company and / or IPs in relation to a group of companies, the outcome of the discussions remain uncertain, and:

- all creditors shall have the right to approach the court for relief, including the initiation of insolvency proceedings in relation to the company; and

- the nature and extent of any guarantees issued to the affected parties by a foreign IP will be a major determinant, if not the decisive factor, of the steps taken by the creditors of the company.

In the event that the guarantees furnished by a foreign IP are the equivalent of a solvent company guarantee as required by the 2008 Companies Act in respect of the audit requirements for a company to remain as a going concern and still fulfil the solvency requirements of the company, the company will not need to be subjected to formal insolvency proceedings. If, however, the guarantees are such that creditors will not be worse off if local proceedings are not convened, then in that situation the company would still for the purpose of the Companies Act be financially distressed, and all affected parties and creditors specifically would be entitled to approach the courts for a winding up or business rescue application.

Having regard to the preeminent position that South African courts give to the rights of local creditors, the writer is of the view that courts would usually come to the aid of creditors and grant any application for formal insolvency proceedings. It would be recommended, however, that the board of the debtor commences voluntary business rescue proceedings in order to obtain a stay of proceedings – thereby granting the

[60] *Richter v ABSA Bank Ltd* (20181/2014) [2015] ZASCA 100 (1 June 2015).

debtor company the ability to reorganise and restructure its affairs having regard to the interests of all affected stakeholders.

4. Legal certainty and predictability

4.1 Legal certainty and predictability to local creditors

In the event that all creditors are amenable to the proposals of the board, then no formalities are required. It will not be possible to obtain legal certainty that the proposals made by a foreign IP, in the absence of recognition having been obtained and / or in the absence of formal local insolvency proceedings, will be accepted by all creditors, and creditors shall at any stage have the right to approach the court for the initiation of insolvency proceedings against the company. The IP's proposals may, however, be tabled as a proposal in terms of section 155 of the 2008 Companies Act (compromise with creditors) which, if accepted, may be formalised by an application to the High Court.

To the extent that business rescue proceedings may be utilised to achieve the desired objective of a restructuring of the local debtor company, all the formalities relating to business rescue proceedings will have to be complied with, albeit that proceedings will be focused on the single individual entity rather than proceedings relating to the group.

4.2 Communications with local courts and creditors

It will not be possible to prevent creditors from applying to court to initiate local insolvency proceedings if a guarantee from a foreign IP is provided. In the absence of designated member states in accordance with the South African CBIA, there is no framework for cooperation between South African courts and foreign courts and / or foreign representatives other than on the basis of comity and convenience.

4.3 Guarantees by the IP in office

As indicated above, it is not likely that a guarantee issued by the IP in the main proceedings will prevent the opening of secondary proceedings. In the case of business rescue proceedings, however, as is common in group structures, the IP will be able to participate in the local proceedings to the extent that he or she is a creditor and shareholder of the local company and will have a significant role to play in the restructuring proceedings of the local entity having regard to local laws.

5. Consolidation of assets

5.1 Procedure with respect to the sale of the whole or part of a business

5.1.1 Sale of assets in business rescue proceedings

During a company's business rescue proceeding, the company may only dispose of its property if it is in the ordinary course of its business, in a *bona fide* transaction approved by the BRP at arm's length for fair value or in a transaction contemplated within, and undertaken as part of the implementation of, a business rescue plan that has been adopted by the requisite majority of creditors.[61]

[61] 2008 Companies Act, s 134(1).

If, during a company's business rescue proceedings, the company wishes to dispose of any property over which another person has any security or title interest, the company must obtain the prior written consent of that person unless the proceeds would be sufficient to settle the debt in full.

Despite these provisions, the actual rescue plan may provide for the sale of assets and / or the business as a going concern.

Section 150 of the 2008 Companies Act sets out the requisite structure and content of the business rescue plan. Section 150(2)(b)(iv) states that the proposals section of the business rescue plan must include the property of the company that is to be available to pay creditors' claims. Further, section 150(2)(b)(v) states that the plan must also include the order of preference in which the proceeds of the sale of such property will be applied to pay creditors.

Voting on the plan has been dealt with above.

In the scenario of an insolvent group of companies, a single reorganisation plan or coordinated reorganisation plans within the group could be achieved by placing each of the companies into business rescue. It should be noted, however, that each of the companies has to be financially distressed in order to be able to commence business rescue proceedings. In practice, this procedure can work well if the same BRP is appointed across all of the companies in the group. However, this is not necessary as long as there is cooperation between the various practitioners.

In this way, through a single reorganisation plan or coordinated similar plans for each company within the group, a coordinated resolution to the group's financial difficulties may be obtained. The key in this model of restructuring is to have all of the business rescue plans consolidated into one document, if possible, or to at least have them comprehensively cross-referenced to each other and be conditional upon each other.

At the meetings of the various companies to consider the various plans, a vote will have to be taken by the respective groups of affected persons to consolidate the plans into one scheme and then, again, separate votes will have to be taken for each company within the group in order to have the whole scheme adopted and to become binding on all affected persons across the group. However, each individual company's rescue proceedings and plan must comply with the 2008 Companies Act in all respects. A restructuring of this nature has the potential for delivering savings across the group's proceedings and maximising value for all affected persons.

In the unreported business rescue proceedings of the Pharmwell Group of Companies, procedural coordination of proceedings was followed as a result of numerous factors, including financiers and lenders being the same throughout the group, the same BRP being appointed to all the different entities within the group, the trade suppliers collectively being the same throughout the group and due to the nature of the business and the movement of stock between the group companies. A combined business rescue plan was adopted which consolidated the proposals to creditors that were applied across the group. Intrinsic to the successful restructuring was the commonality of interests among the body of creditors and the consenting to the common approach by the separate classes of creditors in each of the companies. This resulted in a successful restructuring of all the entities within the group and reduced administrative costs collectively across the group.

In the case of business rescue proceedings that are commenced in respect of a local subsidiary of a foreign group that is undergoing a restructuring, the foreign representative as both creditor and shareholder will have a significant role to play in the proposals made for the reorganisation and / or restructuring of the company. Inter-company claims will not be regarded as independent claims under the 2008 Companies Act and will have a significant impact on the time constraints applicable to the local proceedings, as only independent creditors can vote on the extension of time for the publication of the rescue plan and, while having a voting right, the adoption of a rescue plan will still require the threshold of at least 50% of independent creditors for its successful adoption.

5.1.2 Sale of assets in liquidation or winding-up proceedings

The liquidator in winding up proceedings in respect of a company may apply to the Master of the High Court or any High Court which has jurisdiction in respect of the winding up proceedings to extend the liquidator's powers (both provisional and final liquidators) to authorise him or her to continue trading[62] and / or provide for the right to dispose of the assets of a company.[63] Where a case may be made for the maximising of the value of the estate on the basis of the preservation of the business, such applications are often quite easily granted subject only to the rights of secured creditors in relation to assets subject to any encumbrances. Secured creditors must consent, failing which the requisite approvals may not be obtained. This poses a challenge for the liquidator in cases where the debtors of the company are subject to cessions, as well as in the instances where vehicles which are necessary for the continuation of the operation are subject to instalment sales or lease agreements. The final liquidator is usually granted the necessary authorities for the disposal of the assets at the second or general meeting of creditors where directions for the winding-up and future administration of the estate are granted to the liquidator by creditors after consideration of the liquidator's report.[64] Creditors' voting rights at the meetings are based on the value of the claims submitted by creditors, and a discretion is granted to the presiding officer of the meeting in respect of all decisions taken at the meeting.[65] Any decision by a presiding officer is subject to review proceedings by the High Court.

In the winding up proceedings of related debtor companies, where the assets are linked, a practice has developed akin to procedural consolidation of assets. Assets of the different entities are sold collectively, and the collective sale proceeds are distributed to the respective entities based on a pro rata apportionment of the value realised based on a predetermined formula, usually utilising valuations obtained by the liquidator. The formalities with regards to the asset disposals will have to be complied with in respect of each individual company – i.e. approval of secured creditors and, if applicable, approval of the Master.

In the case of *Pellow v the Master of the High Court,*[66] the court recognised and endorsed the view that the same liquidator being appointed in related entities like that of a group structure is not only acceptable but in some instances beneficial.

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[62] 1973 Companies Act, s 386(4)(f).
[63] *Idem*, s 386(2B).
[64] *Idem*, s 386(4)(h).
[65] *Idem*, s 414(2), as read with Insolvency Act, s 2.
[66] *Pellow NO and Others v Master of the High Court and Others* (2010/22522) [2011] ZAGPJHC 125; 2012 (2) SA 491 (GSJ) (19 September 2011).

Shareholders have very little influence in winding up proceedings, although they are entitled to participate at the meetings of creditors and members.[67]

5.2 Difference in treatment with respect to tangible and intangible assets

There is no relevant different treatment for tangible and intangible assets.

5.3 Role of creditors and creditors' committees in a substantive consolidation

5.3.1 Business rescue proceedings

One of the risks in the above scenario is if the affected persons in one or more of the individual entities do not approve the business rescue plan with the requisite majority voting interests. This could result in the whole scheme falling apart.

In terms of section 145(4) of the 2008 Companies Act, in respect of any decision contemplated in Chapter 6 that requires the support of holders of creditors' voting interests, a secured or unsecured creditor has a voting interest equal to the value of the amount owed to that creditor by the company. Therefore, essentially all creditors have the same voting rights dependent only upon the value of their claim. However, concurrent creditors, who would be subordinated in a liquidation by way of a subordination agreement or similar reason, only have a voting righst equal to what they could expect in a liquidation.

The 2008 Companies Act sets out the functions, duties and membership of committees of affected persons in section 149. Members of the creditors' committee may consult with the practitioner about any matter relating to the proceedings (but not direct or instruct the practitioner), may receive reports or communications on behalf of the general body of creditors and must act independently of the practitioner to ensure fair and unbiased representation of creditors' interests. Only independent creditors may be appointed to the committee. Therefore, the key purpose of the committee is engagement and communication, which is essential in the process.
In the event of a failure to adopt a plan due to insufficient voting interests in support thereof, in terms of section 153(1)(b)(ii), an affected person may make a binding offer to purchase the voting interests of one or more of the dissenting voters at the liquidation value of the interests. It was hoped that this provision would assist in the adoption of just and fair business rescue plans where the process was being stifled by unreasonable creditors. However, in the case of *Kariba Furniture Manufacturers*,[68] the Supreme Court of Appeal ruled that the offer was not binding on the offeree.

Further to the above, section 153 of the 2008 Companies Act provides a mechanism for aggrieved affected persons to approach the court in order to overturn the votes of dissenting affected persons on the grounds that it was inappropriate, which may result in the adoption of the plan.

An adopted business rescue plan is binding on all affected persons, whether or not they participated or voted against the plan.

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[67] "Member" means a person who is a constituent part of that entity (see s 1 of the 1973 Companies Act), and usually includes shareholders.

[68] *African Banking Corporation of Botswana v Kariba Furniture Manufacturers & Others* (228/2014) [2015] ZASCA 69; 2015 (5) SA 192 (SCA); [2015] 3 All SA 10 (SCA) (20 May 2015).

5.3.2 Liquidation and winding-up proceedings

Creditors and shareholders have the right to vote on the proposals presented by a liquidator at a meeting of creditors and members (shareholders).[69]

The voting rights and the outcome of proceedings are based on the proportion of the value of the creditors' claims with the ultimate discretion being in the hands of the presiding officer at the meetings. In the event of disagreement or dissatisfaction with the outcome of the meetings, the High Court may be approached for directions. Creditors have pre-emptive rights in relation to assets subject to securities in their favour. Usually, however, liquidators obtain their authority for the continuation of trading and the disposal of assets in going-concern procedures from the Master of the High Court long before the actual convening of meetings of creditors, and, as previously indicated, the Master shall have decision-making power with regard to the rights of secured creditors only.

5.4 Voting for or against a substantive consolidation

Only subordinated creditors may not have a voting interest in circumstances of their claim having no value in the event of a hypothetical liquidation.

6. Equitable distribution and accountability of IPs

Save in the event of negligence or dereliction of duties, and as long as the plan is adopted with the creditors accepting the inherent risks associated therewith, the IP will not be held accountable in the event of the distribution(s) not being as projected or anticipated. Business rescue plans are inherently based on estimates made in good faith.

7. Intercompany claims

7.1 Order of priority

There is no presumption that related party or intercompany claims are subordinated. Unless otherwise determined, related party claims and their respective voting interests may be exercised at full value. However, as indicated above, certain key decisions by creditors are only decided by independent creditors, and the adoption of the business rescue plan has to be carried by at least 50% of the independent creditors' voting interests.

7.2 Concepts that can alter priority

These concepts of "equitable subordination" or the "re-characterisation" of intercompany debt as equity are not specifically provided for in the legislation. However, these principles may be provided for and determined in a business rescue plan. It is common practice for the BRP to propose the subordination of intercompany and related party debt in order to prioritise independent creditors and for solvency considerations.

[69] *Ibid.*

8. Administering a complex estate in one single consolidated procedure

In exceptional circumstances, more than one group can exist within an enterprise group for insolvency purposes, and this would be possible. However, having regard to the complexities of such a situation, procedural cooperation and coordination is highly unlikely.

Due to the absence of a legislative framework to facilitate the coordination of group proceedings and the territorialism approach adopted by the courts, synthetic group restructurings as envisioned in the *Collins and Aikman* case shall not be achievable in South Africa at this stage.

9. Handling an insolvent parent with a healthy subsidiary

Sections 79 to 81 of the 2008 Companies Act provide for the winding up of solvent companies. However, it is not envisioned that these provisions allow for the solvent company to be included within the insolvent group to the detriment of its creditors. The solvent company will have to be realised by virtue of a sale or disposal of the shares by the IP of its holding company.

SPAIN

1. Consolidated group restructurings versus cooperation or coordination procedure

1.1 Corporate group versus individual legal entity

Apart from exceptional cases that will be dealt with below, Spanish Law does not currently allow "substantive consolidation or commingling" of group companies' assets and any commingling is strictly *procedura*l in nature. However, in December 2021, the Spanish Government approved draft reforms to Spanish insolvency law which purport to transpose Directive (EU) 2019/1023 of 20 June 2019 on preventive restructuring frameworks into Spanish law, and that will attenuate the effects of this ban.

According to article 38 of the Spanish Recast Insolvency Act (RIA), declaration of joint insolvency proceedings against two or more companies of the group may be lodged by directors of those debtors who are part of the same group. Moreover, the joint insolvency of two or more companies can be filed by a common creditor of the relevant companies if either there is a commingling of the assets of the debtors, or they form part of the same group.[1] In both cases, each of the affected companies must be separately insolvent. The insolvency of one company of a group, including the parent company, does not necessarily entail the insolvency of the remaining companies of the group. The competent court to declare the opening of joint insolvency proceedings is that of the place where the debtor with the greatest liabilities has its centre of main interests (COMI) and, if it is a corporate group, that of the controlling company or, in cases in which the insolvency proceedings are not brought against the latter, that of the company with the largest liabilities.

In addition, in cases of pending insolvency proceedings against two or more companies belonging to the same group, article 41 of the RIA allows any of the debtors or the insolvency practitioner (IP) to apply for joinder. In the absence of a petition by any of these parties, any of the creditors may file the request by reasoned writ. Joinder shall be appropriate even when the insolvency proceedings have been declared by different courts. In that case, the competence to process the joinder shall lie with the court that is hearing the insolvency proceedings against the debtor with the highest liabilities at the moment of filing the petition for insolvency proceedings or, when insolvency proceedings have not been declared against it, that which first heard the insolvency proceedings against any of the companies in the group.

Rules on the coordination of corporate group insolvency proceedings are strictly procedural in nature. Group insolvency only implies that different insolvency proceedings can be handled by the same court and under the supervision of the same IP. Accordingly, it does not imply the consolidation of the debtors' assets and liabilities.[2] However, exceptionally,[3] *ex officio* or at the request of any interested party, inventories and lists of creditors may be consolidated in cases where there are commingled assets, and it is not possible to distinguish the ownership of the assets and liabilities without incurring an inappropriate expense or delay.[4]

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[1] RIA, art 39.

[2] *Idem*, art 42.

[3] With regard to the absolutely exceptional character of this rule, see Barcelona Provincial Court, 15 January 2020, Madrid Provincial Court, 2 March 2018, Guipúzcoa Provincial Court, 3 February 2015 and Commercial Court of Madrid, 30 January 2014.

[4] RIA, art 43.

Case law has confirmed that, in contrast with the United Nations Commission on International Trade Law (UNCITRAL) Legislative Guide on Insolvency Law and several national systems, application of article 43 of the RIA is not related to any kind of subjective element (such as the intention to defraud the rights of third parties).[5]

However, the real nature of this rule, which was incorporated by Law 38/2011, remains controversial. Some scholars and the little case law concerning this topic consider it as an exceptional "material commingling",[6] whereas others interpret it as a mere accounting rule.

Apart from corporate group "traditional" insolvency proceedings, Spanish law has a specific regulation for hybrid restructuring frameworks. There are two hybrid restructuring tools: the "collective refinancing agreements" (with no court intervention and only claw-back protection) and "homologated refinancing agreements" (with court intervention and cram down).

According to article 698 of the RIA, in close connection with articles 598 and 599 of the RIA, collective refinancing agreements cannot be clawed back when two requirements are met:

- at least a significant extension of the credit available or the amendment or extinction of obligations, as long as these respond to a feasibility plan that permits continuity of the professional or business activity in the short and medium term; and

- prior to the declaration opening the insolvency proceedings, an agreement has been signed by creditors whose claims represent at least three-fifths of the liabilities of the debtor on the date of adopting the refinancing agreement, as certified by the accounts auditor of the debtor. For the purpose of calculating that majority of liabilities, it shall be deemed that, in agreements subject to a syndication regime, all the creditors subject to that agreement have signed the refinancing agreement when a vote in favour thereof is issued by those representing at least 75% of the liabilities affected by the syndication agreement, except if the rules regulating the syndication establish a lower majority, in which case the latter shall be applicable.

As regards group agreements, this percentage shall be calculated both on an individual basis, in relation to each and every one of the companies affected, and in relation to the credits of each group or subgroup affected, and in both cases excluding from the calculation the liabilities deriving from intra-group loans and credits.

A certification by an accounts auditor regarding the requisite majority is also required. Moreover, the collective agreement must be formalised in a notarial deed. If the above-mentioned requisites are met, the refinancing agreement shall be protected against claw-back actions in case of subsequent formal insolvency proceedings of the debtor.

A group collective refinancing agreement can be judicially "homologated" (homologation is formally similar to the English scheme of arrangement) when it has

5 Commercial Court of Palma de Mallorca, 6 November 2013 and Commercial Court of Madrid, 30 January 2014.

6 *Ibid*.

been signed by creditors who represent at least 51% of the financial credits, although for its effects to be extended, qualified majorities must be achieved.[7] The homologation grants claw-back protection to the refinancing agreement and also allows for the cram down of dissenting creditors (including secured creditors), provided that they hold financial liabilities. Non-participating or dissenting creditors may challenge the resolution approving the cram down, but based on limited grounds (disproportionate sacrifice and failure to meet the requisite majority). Once the judge has accepted homologation, a stay is also available for the debtor. The competence to decide the homologation of a group collective refinancing agreement shall lie with the commercial court of the place where the controlling company has its COMI.[8]

In cases of the homologation of a group refinancing, Spanish courts are nowadays divided as to whether the underlying viability plan shall be an individual plan for each and every company and whether the best interest of creditors test shall be run from a group perspective or from an individual perspective (i.e. the liquidation recovery, as opposed to the plan recovery, shall be a recovery taking into account the liquidation of the group or the liquidation of the specific debtor company). If the group view were to prevail, that might entail a substantive consolidation approach that has been subject to criticism. However, the entity-by-entity analysis seems to predominate, especially since the judgment passed in the *Abengoa* case, which did partially uphold the challenges of certain dissenting creditors to the refinancing.[9]

As highlighted above, the Spanish Government has recently approved draft reforms (Bill) to Spanish insolvency law which purport to transpose Directive (EU) 2019/1023 of 20 June 2019 on preventive restructuring frameworks into Spanish law. The Bill sets out a number of new provisions, including the introduction of restructuring plans (capable of binding dissenting classes under a cross-class cram down if approved by the court), pre-pack insolvency proceedings, and a special abbreviated insolvency procedure for micro companies. It is expected these reforms will be enacted and will come into force by July 2022.

Restructuring plans (RPs) will replace the current refinancing agreements and out-of-court agreements for payment. RPs will be available, not only in cases of imminent and current insolvency, but also when the likelihood of insolvency becomes apparent. RPs will have a very broad scope which will include the transfer of business units and of the whole company.

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7 To extend the effects to dissenting creditors, arts 605 *et. seq* of the RIA distinguish between cases where the creditor has or does not have an *in rem* security. In the first case, the extension of the effects (or cram-down of dissenting creditors) requires consent of creditors representing 60% of financial liabilities to extend deferrals for up to five years, and to convert debt into participating loans during the same term (art 623.1° of the RIA) and consent of creditors representing 75% of financial liabilities to extend deferrals for between five and 10 years, and for debt reductions (unlimited), capitalisation of debts, conversion of debt into ranking financial instruments, different maturity or conditions concerning the original debt, and debt-to-asset conversions or payments in kind (art 623.2° of the RIA). In the case of dissenting creditors with *in rem* security, up to the secured amount, the same effects will extend as provided for creditors not possessing *in rem* security, but only where the agreement is approved by 65%, for the purpose of art 623.1° of the RIA, or by 80%, for the purpose of art 623.2° of the RIA, calculated depending on the proportion between creditors with *in rem* security that have consented to the agreement and the total amount of debt secured with *in rem* security. For the amount exceeding the value of the *in rem* security, the effects of the agreement will extend as stated above for creditors that do not have *in rem* security.

8 RIA, art 609, in close connection with RIA, art 46.1.

9 Judgment dated 25 September 2017, passed by Commercial Court of Seville #2.

Affected claims must be separated into different classes for voting purposes. Separation must be justified on the existence of a class joint interest determined on an objective basis. Conflicts of interest and inter-creditor agreement may be relevant, amongst other issues, for class formation. The Bill provides for a "pre-confirmation" hearing on the adequacy of class formation from the sanctioning court. This "pre-confirmation" forecloses the possibility of bringing a challenge on these grounds at a later stage.

Cram down can only be sought if the plan is sanctioned by the competent court and will not require the express consent of the debtor that is a legal entity (with the exception of SMEs). Court approval is also required to terminate agreements in the interest of the restructuring and to gain protection from possible clawback actions. Moreover, for the RP to be court-sanctioned, it must offer a reasonable prospect of avoiding insolvency, ensure the debtor's viability in the short and mid-term, and impose a proportionate sacrifice on creditors to fulfil these aims. There will also be the obligation to fulfil the requirements of content, form and approval, and equal treatment among creditors of the same class.

The court sanction is subject to the "best interest test" and the "fairness test", the latter based on the "absolute priority rule". However, the "absolute priority rule" can be excluded in cases where it is critical for the debtor's viability and damage to the affected creditors is not unjustified. RPs are capable of binding dissenting classes under a cross class cram down – even those in higher ranks – and shareholders as long as the absolute priority rule is respected. In addition to other requirements, the RP should only be approved in cases where it offers a reasonable prospect of avoiding insolvency, ensures the debtor's viability in the short and mid-term, and imposes a proportionate sacrifice on creditors to fulfil these aims. The Bill gives a possibility for approval of a joint RP. This alternative is specially designed for group of companies. The competence to approve the RP shall lie with the commercial court of the place where the controlling company has its COMI and, in cases where the controlling company is not included in the RP, with the court where the COMI of the company with the highest liabilities. However, the odds are that, once again, future regulation will opt, in general terms, for the entity-by-entity analysis as far as requirements for the approval of the Plan will have to be fulfilled in relation to each of the companies of the group.

1.1.1 *The insolvency and restructuring systems that are in force*

As explained above, group insolvency does not necessarily imply the consolidation of the debtors' assets and creditors. It implies that rules on coordination of corporate group insolvency proceedings contained in articles 38 *et. seq* of the RIA have a strictly procedural nature. Spanish law does not consider the group as a legal person but rather as a "complex enterprise".

1.1.2 *Definition of a corporate group*

The Spanish RIA (Additional Provision 1) contains a specific concept of a corporate group by reference to article 42 of the Spanish Commercial Code (Código de Comercio). This article, modified by Law 38/2011 (which entered into force on 1 January 2012), provides that "a group exists when a company holds or may hold, direct or indirectly, the control over one or several others."

As can be seen, this concept of a corporate group is based on the "principle of control" and excludes "horizontal groups", an exclusion that has been strongly criticised by scholars and which contrasts with the position of the case law prior to the reform.[10]

Article 42 identifies a non-exhaustive list of relationships giving rise to the control of one company (controlling company) over another (dependent company):

> "it has the majority of the voting rights; it has the power to appoint or dismiss the majority of the members of the governing body; it may dispose, by virtue of agreements entered into with third parties, of the majority of the voting rights; or it uses its votes to appoint the majority of the members of the governing body who hold office at the moment when the consolidated accounts must be drawn up and during the two years immediately preceding."

According to a judgment by the Spanish Supreme Court,[11] it must be assumed that a corporate group exists, even when the companies are controlled not by another company but by an individual person. In fact, Additional Provision 1 of the RIA will be modified with the aim to mirror the content of this judgment.

However, the mere existence of the group for corporate purposes does not entail *per se* a substantive consolidation in case of insolvency or hybrid restructuring. As explained, substantive consolidation is only an exceptional remedy.

1.1.3 Legislation relating to corporate groups

A wide "company group concept", which includes both vertical and horizontal groups, was included in a Preliminary Draft of a Commercial Code approved in 2015. However, future development of this draft is uncertain.

1.2 Corporate group versus individual corporate benefit

1.2.1 The existence and relevance of "corporate group benefits"

The "interest of the group" has, at least theoretically, a weak basis within Spanish law and is always subject to the individual corporate interests of the companies that make up the group. The limit of the group interest is ultimately determined by the survival of the subsidiary.

As the Spanish Supreme Court stated in a judgment related to the liability of the director of a subsidiary company,[12] the fact that a company belongs to a group does not imply the total loss of identity and independence. On the contrary, the subsidiary maintains its own identity, goals and specific corporate interests. There are no "group assets", nor a principle of mingling between the assets of each company.[13] According to the Supreme Court view, when there is a conflict between the group interest and that of one of its member companies, a balance should be sought between those interests, so as to permit the proper operation of the group. However,

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[10] Spanish Supreme Court: 6 June 2012, 12 April 2007, 30 July 1999, 13 December 1996 and 16 October 1989.

[11] Spanish Supreme Court, 15 March 2017 and 11 July 2018.

[12] Spanish Supreme Court, 11 December 2015. This case law has been followed by Spanish lower Courts, such as Lugo Provincial Court, 15 October 2018 and Valencia Provincial Court, 22 June 2017.

[13] Spanish Supreme Court, 30 April 2014 and Madrid Provincial Court, 30 January 2020 and 12 July 2019.

such a balance may not result in the "plundering" of the subsidiary. On the contrary, it must be based on "countervailable benefits" (*ventajas compensatorias*), and these benefits may justify actions by the directors that in the opposite case would be considered prejudicial to the company, or that might trigger disadvantages in exchange for the common good of the group, but always provided that the subsidiary also benefits. The benefits for the damaged subsidiary do not necessarily have to be simultaneous or subsequent to the damaging action but may be previous to them. In any event, the economic value of the benefit must be substantial and in proportion to the damage incurred and the benefit must be verifiable.

The RIA contains different examples of the need to balance the interests of the group and the company.

First, one should consider claims from one company against another as "subordinated claims" (*créditos subordinados*). Article 281.1.5° of the RIA provides that in insolvency proceedings, the claims held by "specially related persons" to the insolvent debtor who is a legal entity, in general, shall be regarded as subordinated claims. On the other hand, articles 283.1.3° and 283.1.4° of the RIA consider "specially related persons" as those companies within the same group as the bankrupt and their common shareholders, as long as these fulfil the conditions set forth in article 283.1.4°.[14] The combination of both rules determines the subordination of the claims between companies belonging to the same group for loans, credit facilities and other instruments with a similar purpose to that of a loan.

This rule is based on two main reasons: the possibility of insiders using privileged information about the debtor; and to avoid the risk that the financing provided by a group company could be used to conceal the infra-capitalisation of the debtor company. Article 283.1.3° of the RIA does not indicate when a creditor has to belong to the same group of companies as the insolvent debtor in order to be regarded as a related party. Against the criteria used by the Regional Insolvency Court, the Supreme Court concludes that the relevant time to be considered is the time the transaction under review is entered into.[15]

The second example is the presumption of prejudice to the insolvency assets in all those transactions carried out within the group in the two-year period preceding the opening of insolvency proceedings, as they are considered as made between "specially related persons".[16]

This rule is especially relevant in the case of inter-company guarantees and implies that the transaction could be set aside (or subject to claw-back) unless it can be proved that no harm has been suffered by the financing company. The Spanish Supreme Court considers that it is not enough to invoke the "group interest" in general terms to rule out the existence of harm in an intra-group guarantee.

On the contrary, it is necessary to specify and justify the direct or indirect profit obtained by the guarantor company.[17] Therefore, the burden of proof is shifted onto the group company benefited by the act subject to claw-back.

[14] According to this provision: "Partners who, at the moment at the credit right arising, are direct or indirect holders of at least 5 per cent of the share capital, if the company in insolvency proceedings has securities traded on an official secondary market, or 10 per cent, if it does not have them."
[15] Spanish Supreme Court, 4 March 2016.
[16] RIA, art 228.1°.
[17] Spanish Supreme Court, 30 April 2014.

In the case of upstream or cross-stream guarantees, corporate benefit is more difficult to prove. In contrast, Spanish courts are less suspicious about downstream guarantees on the assumption that they may be justified by the interest of a parent company to preserve the investment in its subsidiary.

Claw-back does not preclude the possibility of bringing other actions based on fraud or specific actions against directors based on the breach of the duty of loyalty owed to the company. The mere fact that, *per se*, parent companies and some of their directors should always exert a degree of control and supervision over their subsidiaries is not enough to consider them as *de facto* directors. Rather, a case-by-case analysis is required. The probability of assuming the existence of *de facto* directors will be higher the greater the level of the group's integration and business centralisation.

The tension between "group interest" and "individual interest" is also visible in the case of collective refinancing agreements and homologation. For instance, it is doubtful whether compliance with some of the requirements referred to in article 5988 of the RIA must be viewed from an "individual" or from a "group" perspective. In particular, it is debated whether there ought to be a "significant extension of the credit available" or an "amendment or extinction of the obligations" for each of the group companies affected or, on the contrary, if it is enough to prove the fulfilment of these requirements for the group as a whole.

The same can be said as regards the "feasibility plan". It is controversial whether "the continuity of the professional or business activity in the short and medium term" must be at "group level" or at "individual level" for each of the affected companies. According to article 283.2 of the RIA, creditors who have signed a refinancing agreement, an insolvency composition or an extrajudicial agreement to pay obligations undertaken by the debtor in relation to a feasibility plan shall not be considered *de facto* directors unless the existence of any additional circumstances can be proven that might justify that treatment. Following the Directive 2019/1023, the Bill introduces a new rule specially designed for RPs. According to the new provision, when the interim financing or the new financing are granted by persons especially related to the debtor, they will only enjoy the protection provided for in section 1 of the previous article if the affected debts, excluding the debts held by these persons, represent more than two thirds of total liabilities.

The "corporate group concept", as defined by article 42 of the Spanish Commercial Code, is considered as the "general group concept" within Spanish law, and it is also referred to in Spanish corporate law (article 18 of the Spanish Corporate Enterprises Act), securities market law (article 5 of the Securities Market Law) and tax law (articles 5, 11, 15 and 21 of the Corporate Tax Act).

As regards labour law, the "company group" concept has been developed by case law. It is assumed that there is a company group when the court deems that a mixture of assets has occurred between a parent company and its subsidiary or when the workers have provided an undifferentiated service to either the parent company or the subsidiary. In these cases, it will be assumed that there is a group of companies for labour purposes, and the court will extend the liability of the subsidiary to its parent company.

1.2.2 *Director liability*

As noted above, according to the Spanish Supreme Court case law,[18] the duty to act as a loyal representative in upholding the interests of a company implies the need to put the interests of the managed company before one's own or those of third parties. This duty of loyalty is in respect of the managed company, not in respect of others, regardless of whether or not they belong to the same group, and even if certain actions are in "the group interest". In the court's own words, "the group interest is not in itself a justification for the damage caused to a subsidiary" and therefore does not exonerate the directors of the affected company from their liability.

Accordingly, a company director must manage the company in a loyal and orderly manner in respect of the corporate interest, regardless of its belonging to a group of companies. The group interest is not "absolute" and damage or jeopardy to the subsidiary may not be justified by the simple interest of the group or because instructions from the group directors were being followed. It is assumed that the director of the company has his or her own sphere of independent decision-making, which excludes any kind of "due obedience".

1.2.3 *"Early warning systems"*

Specific "early warning systems" between the directors of individual legal entities and the parent entity are unknown in Spain.

Within individual companies, article 365 of the Spanish Corporate Enterprise Act basically imposes the director's duty to promote a company's dissolution if a situation of capital impairment or imbalance is not redressed (i.e. when losses drive equity under 50% of the share capital). In addition, the directors have the duty to actively promote the dissolution of the company in the event of cash-flow insolvency (actual illiquidity). According to article 5.1 of the RIA, a debtor shall petition for a declaration to open the insolvency proceedings (or the relevant hybrid instruments such as the Spanish moratorium or "section 583", if applicable) within the two months following the date on which the state of insolvency was known, or ought to have been known. Directors who fail to comply with this requirement shall be held jointly and severally accountable for corporate obligations subsequent to the occurrence of the insolvency event.

1.3 Universalism versus territorial principle

1.3.1 *Application of the modified universalism rules*

Private international law rules contained in the Spanish RIA follow, in general terms, the Regulation (EU) No 2015/848 of 20 May 2015 on insolvency proceedings (EIR Recast) and Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings (EIR) solutions. Therefore, Spanish courts would also apply the modified universalism rules, allowing for the opening of ancillary territorial proceedings in other countries.[19] A territorial proceeding can be opened in Spain where the debtor has an establishment in this country.[20] An establishment is understood as "any place of operations at which the debtor carries out a non-transitory economic activity with

[18] Spanish Supreme Court, 11 December 2015.
[19] RIA, arts 732-735 745.2.
[20] *Idem*, art 49.1.

human means and goods". A foreign territorial proceeding shall be recognised in Spain if it is being dealt with in a state where the debtor has an establishment or in whose territory there is a reasonable connection of an equivalent nature, such as the presence of assets used for an economic activity.[21]

1.3.2 Bilateral and / or multilateral treaties in force

Given that Spain is not party to any convention regulating international insolvency, outside the scope of the EIR and the EIR Recast, ancillary territorial proceedings are governed solely by the RIA.

1.4 Competent court and applicable law

1.4.1 Applicable law that falls outside of the lex fori concursus and related issues

As already noted, the RIA is strongly influenced by the EIR Recast and with very few exceptions (for instance, third-party rights *in rem* over goods located outside the state where the insolvency proceeding is opened),[22] the conflict of law solutions are virtually identical.[23]

1.4.2 Harmonisation of substantive restructuring and insolvency laws

Substantive harmonisation, as envisaged by the Directive of the European Parliament on preventive restructuring frameworks dated 22 June 2019, will undoubtedly help in cross-border cases.

1.4.3 Treaties or case law dealing enforceability

As highlighted above, Spain is not a state party of any convention regulating international insolvency, but UNCITRAL proposals facilitating the cross-border insolvency of multinational enterprise groups could be a good benchmark for future national legal developments.

1.4.4 Upcoming new legislation

The Bill to reform the Insolvency Law confers international jurisdiction on Spanish courts over foreign subsidiaries, when they have jurisdiction to hear pre-insolvency proceedings regulated in Book Two of the Law in relation to the parent company of the group, even when the COMI of the subsidiaries is located outside of Spain. The application of this new forum of international jurisdiction is conditioned on compliance with strict requirements: (i) the parent company has requested the notification regulated in Book Two of the Law or is going to be subject to the RP; (ii) the notification or approval of the RP has been requested as reserved in relation to the subsidiaries, in which case neither the notification nor the resolution on the approval of the plan shall be published in the public insolvency Register; and (iii) the extension of jurisdiction over the subsidiaries is necessary to ensure the successful completion of the negotiations of an RP or the adoption and implementation of the plan. Moreover, the international jurisdiction of the Spanish courts shall only extend to contractual creditors shared by the parent company and its subsidiaries.

[21] *Idem*, art 742.2.2.
[22] Unlike the EIR Recast, which contains an "immunity rule", art 723.1 of the RIA opted for the exclusive application of the law of the state where the good is located.
[23] RIA, arts 722-731.

The fact that the notification or approval of the plan is requested as reserved (confidential) implies that the EIR Recast shall not be applicable and that the new rule could be invoked even in respect of subsidiaries whose COMI is located in the European Union.

2. Substantive consolidated restructuring proceedings versus synthetic group restructurings

The fact that, apart for exceptional cases, Spanish law does not allow "substantive consolidation" of the group companies assets and liabilities, and that each of the companies belonging to the group is a separate legal entity, makes it harder to admit synthetic group restructurings (unless agreed among the relevant stakeholders). In addition, rules on international jurisdiction contained in the EIR, the EIR Recast and the RIA neither recognise the "group interest" nor seem to even allow substantive consolidation exceptions, unless the court has international jurisdiction over all the proceedings.

There have been scarce cases (such as, for instance, *La Seda de Barcelona*, or LSB) where an IP has managed to obtain in practice similar results to those derived from substantive consolidation. However, these results have not been obtained by the IPs by imposition on the affected creditors, but rather through bargaining. In LSB, the global sale of the common business of all of the companies as a going-concern achieved a higher recovery than a fragmented sale, and so the different creditors involved saw the merits of authorising the IPs to follow such a route.

For instance, in LSB, the IP had to manage the insolvent liquidation of a European group of companies located in different member states. The COMI of these companies was located in Barcelona, and thus their respective proceedings were procedurally (not substantially) consolidated before Barcelona Commercial Court #1. Almost no secondary proceedings were opened in other member states. The operating subsidiaries had granted personal guarantees in favour of the financial creditors of the holding company. Some of these guarantees might have been subject to avoidance actions due to the regulation on upstream guarantees in certain member states. However, the IP reached a settlement with the holding company's financial creditors, so that the latter: (i) allowed the sale of the group's business, free and clear, as an asset deal after a competitive process; and (ii) shared in the sale dividend with the holding company's estate according to certain agreed proportions. This solution allowed the IP to manage a situation where the existence of upstream guarantees implied certain substantial consolidation. The solution was a sort of "mitigated substantial consolidation" and not imposed by the regulations but, instead, reached through a compromise among the different stakeholders in view of their common interest.

It should, however, be noted that the current situation is going to experience a change because the Bill will introduce two new "third party release rules", according to which, and in order to facilitate the restructuring of groups of companies, the effects of the RP or of the notification regulated by Book Two of the Law may also be extended to personal or *in rem* guarantees provided by any other company of the same group not subject to the RP, when the execution of the guarantee could cause the insolvency of the guarantor company and of the debtor itself. These new rules could also be invoked in respect of subsidiaries whose COMI is located outside Spain by applying the new rule described in section *1.4.4* above.

3. Duty to initiate insolvency process

The EIR Recast provides a framework that does not allow the opening of a territorial bankruptcy or restructuring proceeding in Spain, if guarantees are provided by an IP in another country that the IP will comply with the distribution and priority rights that local creditors would have in respect of the assets located in Spain (in which secondary insolvency proceedings could otherwise be opened).

Although this does not specifically cover synthetic group restructuring, the new Spanish adaptation rules contained in the Bill could facilitate their future admissibility.

4. Legal certainty and predictability

4.1 Legal certainty and predictability to local creditors

No regulation exists on this point, although voluntary protocols may be entered into. Certainty and predictability could be provided both to local creditors and directors, by means of entering into relevant protocols to assure that the subsidiary: (i) will continue with enough working capital to maintain operations until the sale or restructuring is achieved; and (ii) the estate will not suffer deterioration in the meanwhile. It is also likely that any voluntary protocols would set a maximum period and a minimum value for the sale or the restructuring.

4.2 Communications with the local courts and creditors

Again, no regulation exists on this point. The communication and / or settlement with local creditors could be channelled by means of Spanish voluntary proceedings called "conciliation" (*conciliación*), or as a settlement in the framework of collective or individual enforcement action.

4.3 Guarantees by the IP in office

Again, no regulation exists on this point. This particular issue would depend on the agreement to be reached between the IP and the relevant creditors. The higher the probability of achieving the projected sale or restructuring, the lower the chances a guarantee should be required.

5. Consolidation of assets

5.1 Procedure with respect to the sale of the whole or part of a business

As explained above, rules on joinder of insolvency proceedings are procedural in nature and group insolvency does not imply the consolidation of the debtors' assets and liabilities. Substantive consolidation is admitted only exceptionally by article 43 of the RIA and, apart from doubts as to the actual nature of this norm, the RIA does not have specific provisions ruling on consolidation.

Within insolvency proceedings for individual companies (i.e. on an individual company basis and not a group basis), Spanish law allows for undertaking a sale of a business (either partially or as a whole) under four different scenarios, whose features are broken down below.

The Bill does not amend this absence of substantive consolidation, although it is provided that the eligibility conditions to qualify for the SME special insolvency proceeding must be determined on a consolidated basis if the insolvency petitioner is part of a corporate group of companies.

5.1.1 *Divestment of assets contemplated in a reorganisation plan within insolvency proceedings (***propuesta de convenio***)*

As per the RIA, a reorganisation plan can be filed at different stages of the insolvency proceedings:

- an "advanced proposal" (*propuesta anticipada de convenio*) can be made any time from the petition for insolvency to the deadline for notification of claims, within a month from publication of the insolvency order in the Spanish Official Gazette; and

- ordinary proposals can be filed with the court up to 40 days prior to the creditors' meeting taking place. In cases of more than 300 creditors, the period for filing an ordinary proposal can be shorter.

Ordinary claims are entitled to vote and will be bound by the decision of the majority of the voting claims – whether or not they vote or abstain – whereas subordinated claims cannot vote, but are bound by the reorganisation plan. Finally, secured claims have the right to abstain from voting and not be affected by the reorganisation plan or to vote and be bound by it.

As is expected with the approval of the Bill, "advanced proposals" would no longer remain in force and it is foreseen for ordinary reorganisation proposals to be filed together with the application for insolvency proceeding or at any time thereafter, until 15 days have elapsed since the filing of the IP's report.

As regards approval requirements, depending on whether the restructuring proposed is soft[24] or hard,[25] a reorganisation plan requires the following majorities:

(a) for ordinary claims, the amount of the secured claims that exceeds the value of their collaterals and subordinated claims:

   (i) soft restructurings: at least 50% of the voting claims; and

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[24] Soft restructurings can include any of the following proposals:
(a) write-off not exceeding 50% of the claims;
(b) deferrals of up to five years; or
(c) the conversion of claims into PPLs for a term of the same length.

[25] Hard restructurings can include any of the following proposals:
(a) write-off exceeding 50% of the claims;
(b) deferrals of up to ten (10) years;
(c) the conversion of claims into PPLs or other re-profiling of the claims for a term of the same length;
(d) transfers of assets and rights to the creditors in (or for) total or partial payment of their claims, provided that these assets and rights are not necessary for the continuity of the debtor's business and their fair value is equal to, or lower than, the claim being discharged, without prejudice to the rules governing the transfers of assets guaranteeing secured claims;
(e) payment-in-kind to the creditor that holds a security over the relevant asset, or a third party appointed by said creditor, provided that the secured claim is fully settled or that the outstanding amount of the claim ranks as an unsecured claim; or
(f) the sale of all or part of the debtor's business to a third party, who will have to assume, under the terms agreed in the reorganisation plan, the obligation to continue with the business activity of the debtor.

(ii) hard restructurings: at least 65% of the voting claims;

(b) for the amount of the secured claims that does not exceed the value of their collaterals, the same measures will be applied to dissenting secured claims if the reorganisation plan is backed by the following majorities, which need to be achieved within each class of secured creditors:

(i) soft restructurings: creditors holding at least 60% of the aggregate value of the collaterals of the same class; and

(ii) hard restructurings: creditors holding at least 75% of the aggregate value of the collaterals of the same class;

(c) claims with a general privilege will also be subject to the reorganisation plan if they adhere to it or if it is backed by the following majorities within each class:

(i) soft restructurings: at least 60% of the claims with a general privilege of the same class; and

(ii) hard restructurings: at least 75% of the claims with a general privilege of the same class; and

(d) notwithstanding the above:

(i) if the reorganisation plan provides special treatment to specific groups of creditors, the approval of the majority of the creditors not affected by the special treatment will also be needed (separate voting);

(ii) a reorganisation plan may contain alternative repayment proposals for all or some claims, except for public claims;

(iii) the payments-in-kind cannot be forced upon public claims; and

(iv) the conversions of claims into profit participating loans (PPLs) cannot be forced upon public claims or labour claims.

Finally, authorisation by the general meeting of shareholders is required when the reorganisation plan contemplates debt-for-equity swaps or the disposal or transfer of assets which are essential for the company.[26] In that regard, assets are deemed essential when the sum of the transaction exceeds 25% of the share value shown in the latest approved balance sheet.

The Bill also aims to amend some rules for ordinary reorganisation arrangements. As previously stated, advance proposals would be removed, together with creditors' meetings. In the current RIA, ordinary proposals are voted in a meeting, where creditors meet to vote. The Bill instead foresees that reorganisation proposals shall be voted by means of a written statement *(adhesiones)*, which must be signed and sent to the IP.[27]

[26] Corporate Enterprises Act, art 160f.
[27] Voting method is greatly simplified comparing to the current RIA, still in force.

If the proposal provides for debt-for-equity swaps, the Bill foresees that the directors of the debtor may increase the share capital without the authorisation of the shareholders meeting. Pre-emptive acquisition rights that the original shareholders may have would be also limited.

The Bill also simplifies the implementation of structural changes *("modificaciones estructurales")*[28] provided for in a reorganisation plan, removing the objection that affected creditors may file under the Structural Modifications Act[29] in Spain and determining that the registration of such business transfers would be grounds enough for termination of the insolvency proceeding.

Likewise, it is envisaged that any reorganisation plan may be amended once two years have elapsed since the judicial approval of the plan.

5.1.2 Divestment of assets contemplated in a reorganisation plan reached outside an insolvency proceedings (acuerdo de refinanciación)

Outside "genuine" insolvency proceedings, a group collective "reorganisation plan" (*acuerdo de refinanciación*) can also comprise the sale of assets of the debtor.

An *acuerdo de refinanciación* may be judicially homologated if it has been signed by creditors who represent at least 51% of the financial liabilities and fulfils certain conditions:

- it must significantly increase the funds available to the debtor or amend the terms of existing financing agreements by extending their maturity or by establishing new obligations that replace existing ones;
- it must be backed by creditors who hold a percentage that varies depending on the content of the agreement;
- it must be consistent with a business plan that evidences the viability of the debtor in the short and medium term;
- the debtor's auditor (or, failing that, an auditor appointed by the Commercial Registry) must issue a certificate regarding the sufficiency of the support required to approve the reorganisation plan; and
- it must be notarised together with all its related documents.

Where this sort of reorganisation plan has been signed off by a relevant majority of financial creditors and meets all the requirements detailed above, it will be possible to seek court validation or "homologation" (*homologación*) so that what has been agreed by the debtor and the relevant majority of financial creditors also applies to the financial claims held by dissenting financial creditors, provided that it does not entail a "disproportionate sacrifice" for them.

As explained above, reorganisation plans that may be court-validated are those backed by at least 51% of the financial claims, but this majority does not automatically

[28] Mainly, mergers, spinoffs or global transfer of assets and liabilities.
[29] The Act essentially governs any company transformations, mergers, spinoffs, global transfers of assets and liabilities and international moving of registered offices.

allow the extension of their effects to dissenting creditors. Rather, it just isolates the reorganisation plan from claw-back actions.

What the debtor and the financial creditors can agree under a reorganisation plan and the relevant thresholds needed to cram down or extend the effects to dissenting financial creditors is summarised below:

(a) for claims without a security interest and the part of secured claims exceeding the value of the collaterals:

  (i) deferrals of up to five years or the conversion of claims into PPLs for a term of the same length: 60% of the financial claims; and

  (ii) deferrals of up to 10 years, write-offs, debt-for-equity swaps (with the option for an equivalent write-off for those financial creditors that do not expressly accept the capitalisation of their claims), conversions of financial claims into PPLs or other financial instruments for up to 10 years and the transfer of assets in (or for) total or partial payment: 75% of the financial claims; and

(b) for the part of secured claims that does not exceed the value of the collaterals: the same measures will be applied to dissenting secured claims if the reorganisation plan is backed by financial creditors holding:

  (i) 65% of the aggregate value of the collaterals, for those measures described in (a)(i) above; or

  (ii) 80% of the aggregate value of the collaterals for those measures described in (a)(ii) above.

Again, authorisation by the general meeting of shareholders is required when the reorganisation plan contemplates debt-for-equity swaps or the disposal or transfer of assets which are essential for the company.[30] As stated above, assets are deemed essential when the sum of the transaction exceeds 25% of the share value shown in the latest approved balance sheet.

As anticipated, the Bill replaces the traditional refinancing agreements by the new RPs. The main features of the new RPs can be summarised as follows:

(a) RPs allow all kinds of claims to be compromised, whether financial or operational (conversely, the RIA does not currently allow the refinancing agreement to have an impact on other claims but only on financial ones). Executory contracts could be also amended or terminated if it is deemed appropriate for the interest of the restructuring;

(b) the debtor may implement an RP to modify the composition, conditions or structure of its assets and liabilities, its equity, including transfer of assets, business units or even the entire company, as well as to accomplish any necessary operational changes. The debtor is also entitled to reach an RP with a combination of all these elements;

[30] Corporate Enterprises Act, art 160f.

(c) the debtor is required to classify the claims of creditors into different classes on the basis of a common interest determined by objective criteria;

(d) an RP will be approved by each class of creditors if:

(i) creditors that represent more than two thirds of the total claims in each class vote in favor; or

(ii) being the class formed by secured claims, three quarters vote in favor;

(e) an RP must be judicially sanctioned *(homologación judicia")* whenever it is intended to:

(i) enforce the plan on dissenting creditors, classes of creditors or the shareholders of the debtor (cram-down);

(ii) terminate executory contracts; or

(iii) protect the interim and new financing (as described below) and all the acts provided for in the RP;

(f) the RP needs the approval of all classes of creditors to be judicially sanctioned. However, it could also be sanctioned by the Court even if it has not been approved by all classes, the debtor or, as the case may be, by the shareholders, if it has been approved by:

(i) a simple majority of classes, provided that at least one of them is a class of claims that in an hypothetical insolvency proceedings would have been classified as special or general privileged claims; or

(ii) at least one class which, according to the classification of claims under the insolvency proceedings, may reasonably be presumed to have received any payment following a valuation of the debtor as a going concern. In this case, approval of the plan would require a report of the appointed restructuring expert on the going concern value of the debtor;

(g) if the shareholders' meeting does not endorse any corporate decision that needs their approval, the Bill foresees that such decisions could be carried out without such consent under certain circumstances (regardless of any further objections that shareholders may file on such regard); and

(h) Court-sanctioned RPs that compromise at least 51% of total liabilities of the debtor also secure the interim financing[31] and new financing[32] granted to the debtor by shielding them against claw-back actions and stating that, if an insolvency order is ruled on the debtor, these financings would qualify 50/50 as generally privileged and post-petition claims, respectively.

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[31] Interim financing is described in the Bill as any financing granted by a non-creditor or by a pre-existing creditor if it is necessary and appropriate, at the time it was granted, either to ensure the continuation of the debtor's business or professional activity during negotiations with creditors until the RP is approved, or to preserve or enhance the value of the business or productive units.

[32] New financing is described in the Bill as any financing granted by a non-creditor or by a pre-existing creditor that, having been foreseen in the RP, is considered necessary to comply with the latter.

5.1.3 *Divestment of assets undertaken as part of the liquidation of the company*

In the liquidation phase of the insolvency proceedings, the IP aims to dispose of the debtor's assets to obtain the greatest income possible in order to maximise the recovery of the creditors' claims.

In a scenario where a sale of assets is undertaken within the liquidation phase of the insolvency proceeding, there is no need to obtain the approval of creditors as the aim of disposals at this stage is to merely wind up the company, without prejudice to the rights held by secured creditors in relation to the assets which are securing their claims.

There has been debate on the question of whether authorisation by the general meeting of shareholders is required when the disposal or transfer of essential assets is performed during the liquidation phase, although the most widespread approach is that authorisation shall not be required in liquidation.

The Bill does not provide for relevant changes in provisions stated for company liquidations, although is it established that once a liquidation plan is approved, the Court will have the power to draft special liquidation rules as it deems appropriate, which will prevail over the general provisions.

5.1.4 *Divestment of assets performed through an "article 206 RIA sale" (similar to a Chapter 11 section 363 sale in the United States)*

Article 206 of the RIA exceptionally allows for the disposal of the debtor's assets during the common phase of the insolvency proceedings in relation to:

- acts of disposal that the insolvency receivers consider indispensable to secure the feasibility of the business or the cash flow needs required for the continuity of the insolvency proceedings;

- acts of disposal of assets that are not necessary for continuity of the activity when offers are presented that materially coincide with the value they have been given on the inventory of assets; or

- acts of disposal inherent to continuation of the professional or business activity by the debtor.

Through this sort of disposal, the purchase of debtors' assets during the common phase of the insolvency proceedings can be undertaken in a rapid fashion, allowing for the transaction to be completed swiftly and thus limiting the possible deterioration of the assets in cases where the debtor's business is a "melting ice cube".

In this type of asset sale, there is no need to obtain the approval of the debtor's creditors, without prejudice to the rights of creditors being heard by the court ahead of its decision and to the rights held by secured creditors. The main advantage of business sales conducted through this process is the ability to sell assets free and clear of any debt, security interests or liens, although there are some statutory provisions to protect the rights of security interest holders.

The need to obtain the approval of the shareholders of the company in this case, as opposed to the liquidation scenario, is more doubtful, due to the fact that during the initial common phase the debtor is generally still in possession (unless the IP requests the court to divest the directors).

5.1.5 *Divestment of assets performed by means of a "pre-pack" sale*

This process aims at the preparation of the realisation of the assets of a distressed company prior to the beginning of insolvency proceedings, at the initiative of the debtor and with the supervision of a so-called silent administrator appointed by the Court. A silent administrator may be subsequently appointed insolvency receiver should insolvency proceedings of the debtor be eventually opened in order to execute the relevant business sale.

The sale of businesses (or "productive units") within Spanish insolvency proceedings has proven over the years that the timeframes linked to this sort of process are not always compatible with the maintenance of the workforce, asset value and activity of the business. According to the Bill, the Commercial Court dealing with the transfer of undertakings shall be also competent to determine whether there is (and if so, to what extent) business succession labour-wise.

In turn, business sales proposed by debtors to insolvency courts and receivers are often distrusted, as the latter have not had the opportunity to scrutinise whether the sales process has been conducted with transparency, publicity and real competition between potential bidders. The appointment of a silent administrator ahead of the opening of the insolvency proceedings introduces a mechanism that can eradicate this mistrust problem.

Pre-packs are deemed to align with the rationale and purpose of the Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks as they contribute to the shortening of the length of insolvency proceedings and thus favour the recovery rates within them. Moreover, Spanish pre-packs fall within the scope of the European Insolvency Regulation and so they benefit from its automatic recognition throughout the rest of EU Member States.

Although there is no express regulation on this matter, there are currently several Commercial Courts protocols that deal with how to implement business transfers (Barcelona and the Balearic Islands have their own guidelines on this matter) and several Commercial Courts have recently implemented this business transfer tool prior to the opening of the insolvency proceeding.

These pre-pack business sales guidelines, which are already a practical reality in the judiciary of Spain, are set out in the Bill, determining by way of statute the process that reorganisations shall follow.

5.2 Difference in treatment with respect to tangible and intangible assets

There is no difference in treatment between tangible and intangible assets in relation to the sale processes outlined above.

5.3 Role of creditors and creditors' committees in a substantive consolidation

Because Spanish law excludes substantive consolidation as a rule in a group restructuring per se, any contemplated "consolidation plan" for several group companies that provides for substantive consolidation must be approved by the requisite majorities required with respect to each and every company, *individually considered*, both in insolvency proceedings or hybrid restructuring proceedings. Otherwise, the plan shall not be confirmed by the court and fall away. And, even if approved by the requisite majorities, the plan containing the substantive consolidation between group companies shall abide with, among other things, the "no worse off test" and "fairness test", as applicable.

The Bill foresees the possibility to submit joint RPs. In this case, it is possible to apply for the Court to sanction *(homologación)* the RPs both individually or jointly. In the latter case, however, each of the debtors must comply with the requirements set out by the Bill to sanction the RP individually considered.[33]

5.4 Voting for or against a substantive consolidation

Out-of-the-money creditors would have the ability to vote down a substantive consolidation plan within formal insolvency proceedings (*concurso*), in which there is no enterprise value determination as a criterion to resolve which claims are in or out of the money. However, that should not be the case in homologation, where valuation should be looked at – albeit Spanish case law on this respect is still inchoate, but quickly evolving.

6. Equitable distribution and accountability of IPs

Issues in relation to reorganisation plans and all related matters are described above (see section 5.1).

7. Intercompany claims

7.1 Order of priority

There is an irrefutable presumption that inter-group claims must be considered as subordinated claims.

7.2 Concepts that can alter priority

Spanish law considers the directors of a company and shareholders which have a significant share in a company as "persons specially related". It implies that when the financing needs of the company are met by loans granted by those persons in cases where a diligent businessperson would have covered such needs through capital contributions (nominal undercapitalisation), directors and shareholders shall be qualified as subordinated creditors within an eventual insolvency proceeding.[34] Moreover, loans granted in the two years preceding the declaration of insolvency can be set aside (clawed back or rescinded) by the Court unless it is proved that the loan was not detrimental to the estate.

It must be mentioned that the Bill provides that new financing and interim financing granted or committed by specially related persons shall, in a Court-sanctioned RP

[33] The approval and sanctioning requirements are different depending on the classes that have voted for the plan. It could therefore happen that in a corporate group restructuring, all classes of one debtor have voted in favor of the RP, but in another one some classes or the shareholders have voted against it. In this scenario, different requirements must be fulfilled in order to sanction the RP, regardless of the fact that a joint application has been filed with the Court.

[34] See Spanish Supreme Court, 10 July 2013.

affecting more than two thirds of the debtor's total liabilities, be classified, in a subsequent insolvency proceeding, 50% as a claim against the estate and the remaining 50% as a general privileged claim. Besides, such financing will be also protected from further claw-back action if the latter conditions are met.

8. Administering a complex estate in one single consolidated procedure

Spanish law does not allow consolidated group restructurings, either within one group or for more than one group within an enterprise group for insolvency purposes. In cases where the state of the debtor is too complex, an assistant to the IP (*auxiliar delegado concursal*) may be appointed.[35] However, the solution to complexity in Spain is not substantive consolidation, which could affect the Butner principle, but the contribution of more resources so as to adequately manage the higher degree of complexity of the situation.

As explained above, the admission of synthetic corporate group restructurings in the near future is improbable and left to the will of all of the affected parties. Besides, the European Commission has also recently rejected, *a priori*, the inclusion of "third-party release" mechanisms in its Directive on preventive restructuring frameworks. Indeed, third-party releases could also be considered as a sort of synthetic corporate group restructuring tool.

9. Handling an insolvent parent with a healthy subsidiary

According to Spanish law, the insolvency of one company of the group, including the parent company, does not necessarily imply the insolvency of the remaining companies of the group. The rules on related insolvency proceedings (*concursos conexos*) contained in articles 38 to 43 of the RIA can be invoked only when requirements demanded for opening an insolvency proceeding are fulfilled against *all* of the companies. In other words, companies cannot be dragged into an insolvency proceeding just because they simply belong to the same group as an insolvent company.

[35] RIA, art 75.1.

THE NETHERLANDS

1. Consolidated group restructurings versus cooperation or coordination procedure

- **National cases**

The Dutch Bankruptcy Act (DBA) provides for three types of insolvency proceedings for legal entities: (i) bankruptcy (*faillissement*), which is aimed at liquidation of the company; (ii) suspension of payment (*surseance van betaling*), which assumes business continuity, and (iii) court confirmation of extrajudicial restructuring plans (*homologatie van een onderhands akkoord,* or WHOA), which is technically not an insolvency proceeding but instead a restructuring procedure outside of bankruptcy.

Traditionally, the DBA did not provide a legal basis for substantive or procedural consolidated group restructurings or insolvencies. This changed to a certain extent when the WHOA entered into force on 1 January 2021.

A statutory framework for a consolidated group insolvency in bankruptcy or suspension of payments proceedings is still lacking. However, Dutch courts have, to some extent, in practice allowed the consolidation of bankruptcy proceedings. The option, and extent, of consolidation is discussed below for each type of insolvency proceeding.

Suspension of payments proceedings

As far as we know, consolidation of suspension of payments proceedings has never occurred. This is not surprising as the most prominent legal ground for consolidation has long been that the assets of the relevant companies have commingled in a way that does not allow a reasonable attribution of these assets to the individual companies. This implies a lack of proper bookkeeping that is incompatible with suspension of payments proceedings. Under Dutch law, one of the requirements for the final granting of a suspension of payment to a company is the favourable vote of its creditors on the company's request for such proceedings. In order to obtain a favourable vote, the company has to convince its creditors that it is essentially viable. This requires the books to be correct and in order, which is evidently irreconcilable with the main legal ground for a consolidated insolvency (specifically, an untraceable commingling of assets).

Bankruptcy proceedings

As noted above, case law does sometimes allow substantive consolidation of the assets and liabilities of a bankrupt company. The Supreme Court of the Netherlands (*Hoge Raad der Nederlanden*) allowed the consolidated liquidation of two bankrupt companies *in re VKB / Trustees Zilfa and DCW*.[1] From this latter case, it follows that the main requirement for allowing the consolidated liquidation of a group of companies is that their assets have commingled in such a way that they cannot be attributed to the individual entities in a reasonable way. If this is the case, all assets and all liabilities are considered to be part of one and the same joint estate. Creditors file their claim as if there was only one insolvency, regardless of their original or formal debtor. All creditors share in

[1] Dutch Supreme Court, 25 September 1987, ECLI:NL:PHR:1987:AC9980 (*VKB c.s./Trustees Zilfa and DCW*).

the joint bankruptcy estate. In *Re Infotheek*,[2] additional grounds for consolidation were formulated. The court held the following arguments to be conclusive:

- a lack of administrative implementation of the legal structure of the companies;
- the occurrence of a number of intercompany transactions, which had been documented improperly or at least in an unclear way;
- insufficient distribution of costs among the companies;
- as a result of the joint and several liability of the companies towards the lenders, the ordinary creditors would not receive any distribution from the individual bankruptcy estates;
- the lack of separate financial statements and the impossibility of compiling those, in combination with the declaration of joint and several liability by the reporting parent company based on article 2:403 of the Dutch Civil Code (DCC);[3] and
- the lack of non-arbitrary standards for the allocation of an important part of the assets.

In *Re Van Boven q.q. / Leenhouts' Aannemingsbedrijf,*[4] the court ruled that, because a single legal basis for consolidation was lacking, the detailed consequences of a consolidated restructuring or insolvency are to be determined based on the specific circumstances of the case, provided that these consequences are in compliance with the existing legal regulations.

Because of the abovementioned far-reaching consequences of consolidated liquidation of group companies, substantive consolidation hardly ever occurs.

Another, less far-reaching, form of consolidation is *procedural* consolidation, aimed at a fair distribution of the liquidation costs among the various group companies. This kind of consolidation occurs quite often in the Netherlands. In such cases, the courts appoint one and the same bankruptcy trustee in the bankruptcy proceedings for all related entities. For any liability other than the liquidation costs, the bankruptcies are handled as individual bankruptcies. This means that creditors have to lodge their claims in the individual bankruptcy of their debtor and share only in the proceeds – if any – of the bankruptcy estate of their specific bankrupted debtor. The liquidation costs, however, are aggregated from all related bankruptcies rather than being allocated to the individual bankruptcies. Subsequently, the costs are arbitrarily paid out of the bankruptcy estate(s) containing sufficient funds. The legal reason for this type of procedural consolidation is that the liquidation costs are made on behalf of all

2 District Court The Hague, 27 December 1995, *JOR* 1996/87 (*Infotheek*).
3 Under art 2:403 of the DCC, a subsidiary is exempt from publishing its individual annual accounts if, among other things, its financial statements are consolidated into the annual accounts of its parent company and that parent company has declared itself to be jointly and severally liable for the subsidiary's liabilities arising from legal acts.
4 Court of Appeal The Hague, 22 November 2011, ECLI:N:GHGR:2011:BU8621 (*Van Boven q.q./Leenhouts' Aanemingsbedrijf*).

group companies and cannot be reasonably allocated to individual bankruptcies. For example, if one group company is party to the lease contract but all group companies use the real estate, the costs incurred for the termination of this lease and the vacation and transfer of the real estate cannot be allocated solely to the lessee. Those costs have to be borne by all group companies that benefited from the lease, so consolidation of costs is obvious. Furthermore, quite often there is a negative (group) balance, so without consolidation the insolvency practitioner (IP) would not be able to settle the liquidation costs. This is related to the fact that, under Dutch law, the liquidation costs, including the IP's salary, are paid out of the bankruptcy estate. If the bankrupt company is devoid of any assets, there are no funds to cover the liquidation costs. In that case, the IP receives no salary. As the majority of bankruptcy estates in the Netherlands end up with a shortfall and group companies are no exception to those rates, consolidation of liquidation costs regularly occurs in the Netherlands.

Another phenomenon, somewhat related to the procedural consolidated liquidation of group companies, is consolidated reporting by the IP. The DBA obliges an IP to regularly publish a bankruptcy report. Almost every IP appointed in a bankruptcy of two or more group companies will file consolidated bankruptcy reports from an efficiency and cost-reduction perspective. As this does not in any way result in substantive consolidation, this form of consolidation will not be discussed in this paper.

Since there currently is no legal basis for substantive consolidation for group companies through bankruptcy proceedings, there are no hard and fast rules regarding the cooperation and coordination between courts and IPs. Usually, the bankruptcy orders are given per individual company, but the appointed IP and appointed supervisory judge are the same in all related bankruptcy proceedings.[5] Hence, there is no need for specific cooperation and communication among the various bankrupt estates. If group companies are declared bankrupt at different times, the court will usually appoint the same IP as has been appointed in the previously ordered bankruptcies. If a group company needs to file for bankruptcy with another court due to jurisdictional issues, this court will usually refer the follow-up treatment of the bankruptcy to the court that handles the other bankruptcies, and the same IP and supervisory judge will be appointed. This makes cooperation and coordination between different courts and IPs in a group insolvency unnecessary. An exception to the appointment of a single IP with regard to group companies is the existence of a possible conflict of interest between the companies, for example where there are disputed intercompany claims. In this case, in order to enhance coordination and cooperation between the court and the different IPs, the appointed supervisory judge will be one and the same person. In case of a conflict of interest, coordination and cooperation between IPs is often complex. Should cooperation and coordination be opportune for certain aspects of the bankruptcies, the supervisory judge will put the IPs in touch with each other on these issues. We are unaware of any Dutch bankruptcies in which a group coordinator has been appointed. This is, however, an option under the

[5] As a general rule, only one IP is appointed. However, if the nature and size of the (group of) companies so demand, two IPs can be appointed (DBA, art 14(1)), especially if conflicts of interests between one or more group companies are envisaged.

European Union (EU) regulation on insolvency proceedings (EIR Recast),[6] as will be discussed below.

The WHOA

The WHOA provides a legal basis for specific consolidated restructuring of group companies with respect to their obligations to perform or to grant security to creditors of the main debtor for its obligations. The WHOA introduces extrajudicial restructuring through a restructuring plan that can become binding on all affected creditors and shareholders through court confirmation of the plan once it has been approved by at least one class of in-the-money creditors (cross-class cram down). An extrajudicial restructuring plan in accordance with the WHOA may include the obligations of group companies towards the performance or security for the main debtor's creditors if the following requirements are met:[7]

- the group company whose obligations are to be included in the restructuring plan has to meet the light insolvency test applied by the WHOA – so that the debtor considers it reasonably plausible that it will be unable to pay its future debts as they fall due;

- the Dutch court would have jurisdiction if the group company itself were to offer a restructuring plan under the WHOA; and

- the group company has agreed to the restructuring of its obligations towards the main debtor's creditors, or the restructuring plan is offered by a court-appointed plan expert.

If these conditions are met, group finance obligations, such as parent guarantees or sureties, can be included in the restructuring plan without the guarantors themselves going through a WHOA restructuring. For instance, if a company's debt has been secured by an upstream or a downstream guarantee, a claim based on this guarantee can be included in the restructuring plan of the original debtor. This prevents creditors of groups of companies from a practice often referred to as double dipping.

There is no framework for cooperation and coordination of courts and IPs in WHOA proceedings. If a group of companies wishes to consolidate all or some of the obligations of a group company towards the main debtor's creditors, the consolidation is limited to only these selected obligations. The consolidation of these obligations in the main debtor's WHOA's proceedings does not result in WHOA proceedings for the group company itself. Therefore, there are no conflicting proceedings and there is no need for any cooperation or coordination between courts and IPs.

Additionally, a WHOA restructuring is a debtor-in-possession proceeding. As a starting point, the debtor itself offers the restructuring plan to all or some of its creditors and shareholders without the involvement of any IP. Another option is that the restructuring plan is offered on behalf of the debtor by a plan expert,

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6 Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast).

7 DBA, art 372(1).

who is appointed at the request of either the debtor or its creditors, shareholders, works council or employees' representative. However, even then, the plan expert does not have any power other than to design and negotiate the restructuring plan, and to obtain court confirmation thereof. So also in this case, no IP who can exercise control over the debtor's assets is appointed. Consequently, there is no need for any rules on cooperation and coordination between courts and IPs.

In theory, a court could appoint a plan expert for company A whose obligations towards company B are being consolidated in the plan expert-led WHOA proceedings of company B. To prevent conflicting offers being made in regard to the same obligations of company A, some sort of cooperation and coordination between IPs (in this case, the plan experts) would be helpful. We are currently not aware of any case law on this topic. We expect the plan experts to easily solve any issue that may arise as companies A and B are part of the same group of companies and they have the same goal: the restructuring of the obligations of main debtor company B, for which co-debtor company A is also liable.

- **Cross-border cases**

EU cases

For a restructuring or insolvency of a group of companies incorporated under different EU jurisdictions, the EIR Recast applies.[8] According to article 7(1) of the EIR Recast, the principle applicable law to insolvency proceedings is the *lex fori concursus*. Therefore, if insolvency proceedings are opened in the Netherlands, the DBA is applicable, and the process described in this section under the heading “National cases” above applies.

In addition, the EIR Recast provides for cooperation and communication between IPs that have been appointed in the insolvency proceedings of two or more group companies. According to the EIR Recast, IPs need to cooperate to such an extent as: (i) is appropriate to facilitate the effective administration of the insolvency proceedings of the group companies; (ii) is not incompatible with the rules applicable to the proceedings; and (iii) does not entail any conflict of interest. Cooperation may take any form, including through agreements or protocols. Cooperation of IPs may include the grant of additional powers to one IP or the allocation of certain tasks among IPs, provided this is not incompatible with the rules applicable to the insolvency proceedings at hand.

Furthermore, the EIR Recast provides for cooperation and communication between courts. If a court has opened insolvency proceedings relating to one or more group companies, it has to cooperate with any other court before which a request to open proceedings in relation to another group member is pending or which has opened such proceedings. The extent of this cooperation is the same as for IPs, so that the cooperation: (i) needs to be appropriate to facilitate the effective administration of the proceedings; (ii) cannot be incompatible with the applicable rules; and (iii) may not entail any conflict of interest.

[8] Insolvency proceedings that have been opened before 26 June 2017 are governed by Council Regulation (EC) No 1346/2000 of 29 May 2000 on insolvency proceedings (EIR).

To enhance the cooperation and communication between courts, they may appoint an independent person or body to act on their instructions. The courts (or appointees) may communicate directly with, and request information or assistance directly from, each other, provided that the procedural rights of the parties to the proceedings and the confidentiality of the information is respected.

Finally, under the EIR Recast, IPs and courts have to cooperate and communicate together. An IP appointed in the insolvency proceedings of one group member may also request information from a court concerning the proceedings of another group member, or request assistance concerning the proceedings in which the IP has been appointed. This type of cooperation and communication between the IP and the court is also restricted to the extent that it: (i) is appropriate to facilitate the effective administration of the proceedings; (ii) does not entail any conflict of interest; and (iii) is not incompatible with the rules applicable to the proceedings.

The EIR Recast provides an IP, appointed in the insolvency proceedings opened in respect of a group company, with certain powers relating to insolvency proceedings of other group companies. For instance, the IP may be heard in any of the proceedings opened in respect of another group company, may (under limited conditions) request a stay of any measure related to the realisation of the assets in the proceedings opened with respect to another group company, or can apply for the opening of group coordination proceedings.

If this type of proceeding is opened, a coordinator will be appointed. The coordinator is someone eligible under the law of an EU member state to act as an IP. The coordinator cannot have already been appointed as IP in respect to any of the group companies and must be without conflict of interest concerning any of the related parties (group companies, creditors and so forth). The coordinator has certain powers, including powers to make recommendations or propose a plan for the coordinated approach of the insolvency proceedings of the group companies. The coordinator can also mediate disputes between IPs and request a stay of proceedings opened with respect to a group company if this is necessary for the implementation of a group coordination plan. The coordinator’s recommendations and group coordination plan are, however, non-binding for IPs handling insolvency proceedings of group companies.

Exception: undisclosed WHOA

A relevant exception to the above applies to the undisclosed variant of a WHOA procedure. The WHOA is available in two variants: an undisclosed one and a public one. The public WHOA has been added to annex A of the EIR Recast and is consequently subject to the EIR Recast. The undisclosed WHOA does not meet the EIR Recast's publicity requirement as the proceedings remain undisclosed to the public and hearings are held in chambers. These proceedings are therefore not governed by the EIR Recast but solely by Dutch law – so no provisions for cooperation and coordination between courts and IPs apply.

Non-EU cases

Dutch law does not provide for any rules regarding the consolidation of Dutch restructuring or insolvency proceedings with restructuring or insolvency proceedings opened in a jurisdiction outside of the EU. In *Re Oi Coop / Citadel*[9] and *re PTIF / Citicorp,*[10] the Supreme Court held that, if national or international rules are lacking, the DBA is applicable to the restructuring of a company incorporated under Dutch law, even if the company is part of an international group of companies that has a foreign centre of main interests (COMI) and is subject to foreign restructuring. However, in so far as the DBA allows for this, the foreign restructuring process can be taken into account. This means that a Dutch IP may keep the group interest and the interest of the group creditors in mind when determining his or her course of action.

An example of a Dutch bankruptcy trustee taking a non-EU restructuring into account is the Cross-Border Insolvency Protocol agreed upon by the Dutch bankruptcy trustee and the Indian resolution professional of Jet Airways. This protocol had been ordered by the Indian National Company Law Appellate Tribunal, after recognising the Dutch bankruptcy proceedings and the authority of the Dutch bankruptcy proceedings regarding the Dutch Jet Airways company.[11]

1.1 Corporate group versus individual legal entity

1.1.1 The insolvency and restructuring systems that are in force

The DBA only applies to the company that is the formal subject of the relevant provisions. If a legal entity enters any of the insolvency proceedings provided for in the DBA, that does not affect any other legal entity under control of the same entrepreneur.

1.1.2 Definition of a corporate group

Article 2:24b of the DCC contains a definition for a corporate group, being "an economic entity in which legal entities and companies are organisationally linked." Furthermore, it states that "[g]roup companies are legal entities and companies that are linked in a concern." This definition is used throughout all corporate legislation; its use is not limited to provisions on fraud or abuse of goods. The definition of article 2:24b of the DCC is not limited to Dutch companies either, so that companies incorporated under foreign law can also be a group company in accordance with article 2:24b of the DCC.

1.1.3 Legislation relating to corporate groups

There is no draft legislation regarding this issue.

1.2 Corporate group versus individual corporate benefit

1.2.1 The existence and relevance of "corporate group benefits"

The corporate group benefit concept does not exist in the DCC, but it is recognised in case law. One of the first decisions in which the group benefit is mentioned is a tax case dating back to 1978.[12] In this case, a parent company had issued an

[9] Supreme Court 7 July 2017, ECLI:NL:HR:2017:1280 (*Oi/Citadel c.s.*).
[10] Supreme Court 7 July 2017, ECLI:NL:HR:2017:1281 (*PTIF/Citicorp*).
[11] National Company Law Appellate Tribunal New Delhi 26 September 2019 (*Jet Airways*).
[12] Supreme Court 31 May 1978, ECLI:NL:PHR:1978:AX2866 (*Zweedse grootmoeder*).

interest-free loan to a subsidiary. The Dutch tax authorities considered this to be a tax profit for the subsidiary. The Court of Appeal dismissed this view by accepting the argument that the parent company did not calculate interest because this was in the interests of the corporate group as a whole. The Supreme Court sanctioned this decision, thus accepting the corporate group benefit as a stake to be taken into account by a group of companies. Ever since this decision, both the lower courts (especially the Netherlands Enterprise Court, *Ondernemingskamer*) and the Supreme Court have accepted the corporate group benefit as a concept in multiple cases.

1.2.2 Director liability

Under Dutch law, the corporate group benefit is *contributory* to the individual corporate benefit but cannot overrule the individual corporate benefit or prevail over the other interests at stake.[13] In so far as Dutch law allows this, the fact that a company is part of a group – and the interest of that group and the group's creditor body – can be taken into account when determining a group company's policy.[14] Nevertheless, the individual corporate benefit must always be regarded as primary, which means that directors' liability has to be judged per legal entity. Therefore, in the end, a director's primary duty is towards the legal entity and not the group as a whole. However, in case of a holding company, case law suggests that its individual corporate benefit includes the benefit of its subsidiaries because in itself, a holding company does not have any undertaking. Consequently, the undertakings of the subsidiaries should be deemed to be included in the holding company's individual corporate benefit. When in distress, a holding company should therefore still consider the interests of its subsidiaries and their stakeholders, and not just its own interests and the interests of its own stakeholders.

1.2.3 "Early warning systems"

Under Dutch law, directors of a public limited company (NV) are obliged to convene an extraordinary shareholders' meeting as soon as it becomes plausible that the net assets of the company have dropped to or below half of the paid and called-up part of the capital.[15] The purpose of the meeting is to discuss whether the company should be dissolved or whether special measures need to be taken to amend the situation. If the directors do not fulfil their obligation to convene a shareholders' meeting, this can be used to argue that they have mismanaged the company.[16]

1.2.4 Pending or draft legislation

There is no draft legislation regarding this issue.

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[13] Dutch Supreme Court 31 January 2002, ECLI:NL:HR:2001:AD4508 (*Juno*) and Supreme Court 4 April 2014, ECLI:NL:HR:2014:797 (*Cancun*).
[14] Supreme Court 7 July 2017, ECLI:NL:HR:2017:1280 (*Oi/Citadel c.s.*) and Supreme Court 7 July 2017, ECLI:NL:HR:2017:1281 (*PTIF/Citicorp*).
[15] DCC, art 2:108a.
[16] Netherlands Enterprise Chamber 7 January 1988, ECLI:NL:GHAMS:1988:AB9641 (*Bredero*).

1.3 Universalism versus territorial principle

1.3.1 Application of the modified universalism rules

As the EIR and EIR Recast apply in the Netherlands, the modified universalism rule is applicable, meaning that ancillary proceedings can be opened in accordance with the EIR and EIR Recast. For non-EU (including Danish) cross-border restructurings or insolvencies, the territorial principle prevails, although the effects of this principle have been strongly limited.[17] According to the Dutch Supreme Court, this means the following:[18]

- Dutch assets are not part of the foreign bankruptcy attachment;
- the legal consequences of the foreign insolvency, as provided for in the foreign insolvency law, cannot be invoked in the Netherlands in so far as this would limit unpaid creditors in their recourse on Dutch assets; and
- any other legal consequence of the foreign insolvency can be invoked in the Netherlands.

This means, in short, that an IP, appointed in a non-EU bankruptcy, can sell and dispose of Dutch assets and use all of the powers granted by the insolvency laws applying to the foreign bankruptcy (*lex concursus*) as long as this does not limit unpaid creditors in their recourse to Dutch assets and the foreign IP's actions are not contradictory to Dutch mandatory law. So, for instance, the declaration of a Dutch or an EU bankruptcy results in the automatic attachment of all assets of the bankrupt company (the bankruptcy stay). A non-EU insolvency will not have that effect because that would limit the recourse of unpaid creditors to the attached assets. This does not, however, prevent the foreign IP from selling the assets. But, until the moment the IP does this, the assets remain available for recourse by unpaid creditors, whereas in case of a Dutch or EU insolvency individual creditors would no longer be allowed to seek recovery from the assets of the estate, wherever these assets are located.

1.3.2 Bilateral and / or multilateral treaties in force

Apart from the EIR Recast, the Netherlands is not a party to any bilateral or multilateral insolvency law treaties.

1.3.3 Pending legislation

There is no draft legislation regarding this issue.

1.4 Competent court and applicable law

- **National cases**

Under the DBA, the competent court is the court of the place of business of the company, with "place of business" meaning the place of the company's

[17] Dutch Supreme Court 2 June 1967, ECLI:NL:HR:1967:AB3520 (*Hiret/Chiotakis*) and 31 May 1996, ECLI:NL:HR:1996:ZC2091 (*Coppoolse/De Vleeschmeesters*).
[18] Dutch Supreme Court 13 September 2013, ECLI:NL:HR:2013:BZ5668 (*Yukos*).

registered office.[19] As Dutch law does not contain any provisions for consolidated bankruptcy proceedings, the courts' competence has to be determined for each of the group companies individually. In case of a WHOA restructuring, the group of companies may address any court that has jurisdiction based on the place of business of either the main debtor or one or more of the co-debtors. Once a choice is made, this is final and from then on, the court addressed is the only competent court in regard to the entire group restructuring.[20]

- **Cross-border cases**

Under Dutch law, if the insolvent company is no longer located in the EU, the court of its last place of business within the EU is competent. If the company does not reside within the EU but does conduct business in the EU, jurisdiction lies with the court of its place of business.

In case of a restructuring or insolvency of a group of EU companies, the EIR Recast applies. For main insolvency proceedings, the courts of the EU Member State within the territory where the company's COMI is situated have jurisdiction. Under the EIR Recast, the COMI is the place where the company conducts the administration of its interests on a regular basis and which is ascertainable by third parties. The place of the company's registered office will be presumed to be its COMI in the absence of proof to the contrary. However, that presumption only applies if the registered office has not been moved to another EU Member State within three months prior to the request for the opening of insolvency proceedings. If the company's COMI is situated within the territory of an EU Member State, the courts of another Member State will only be competent to open insolvency proceedings if the company has an establishment within the territory of that other Member State. The effects of those proceedings are restricted to the assets situated in the territory of the latter Member State, turning the proceedings into secondary insolvency proceedings.

The EIR Recast does not provide any rules regarding jurisdiction relating to the insolvency of a group of companies, except for the provision that group coordination proceedings can be opened by any court that has jurisdiction over the insolvency proceedings of a member of the group.

- **Exception: undisclosed WHOA**

As set out above, the undisclosed WHOA is not governed by the EIR Recast. We have argued[21] that the undisclosed WHOA is governed by the Recast Brussels Regulation.[22]

Under the Recast Brussels Regulation, a company has to be sued in the courts of

[19] DBA, art 2(1) in conjunction with DCC, art 2:10.
[20] *Idem*, art 369(8).
[21] Vriesendorp et al, *Automatic recognition of the Dutch undisclosed WHOA procedure in the European Union*, NIPR 2021/182.
[22] Regulation (EU) No. 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters (recast).

its Member State.[23] In case of a consolidated group restructuring, the courts for the place where any of the group companies is domiciled will also have jurisdiction.[24] If our stance, that the Recast Brussels Regulation applies to the undisclosed WHOA does not hold true, because this issue has ultimately to be decided by the CJEU, the rules set out above for national cases apply.

1.4.1 Applicable law that falls outside of the lex fori concursus and related issues

National cases and undisclosed WHOA restructuring proceedings are governed solely by Dutch law which contains no exception to the *lex fori concursus*. The same applies to non-EU cross-border insolvencies, due to the fact that the universalism principle prevails in the Netherlands (as outlined above).

EU cross-border cases are governed by the EIR Recast. Under the EIR Recast, the basic principle is that the *lex fori concursus* applies to the insolvency proceedings and all of its effects.[25] The EIR Recast does, however, list several important exceptions to this rule, such as third-party rights *in rem*, a creditor's right to set off, a seller's right on a reservation of title, contracts relating to immoveable property and contracts of employment. Most exceptions do not specifically exclude the *lex fori concursus* from applying but, instead, introduce the law of a specific other EU Member State as an additional exclusive applicable law. Almost every exception is based on the basic principle that parties cannot be deprived of an entitlement following from the law which is applicable to their claim or right or to the assets at stake.

1.4.2 Harmonisation of substantive restructuring and insolvency laws

As there is no exception to the application of the *lex fori concursus* for non-EU cross-border cases and the undisclosed WHOA, other than Dutch mandatory rules of law, there is no need for harmonisation.

For EU cross-border cases, the exceptions contained in the EIR Recast could have the effect that the legal framework for certain assets differs substantially depending on the location of the assets or the party involved, while being covered by one and the same insolvency proceeding. These differences are detrimental to the legal certainty that is one of the main reasons for the adoption of both the original EIR and the EIR Recast. Harmonisation of the restructuring and insolvency laws of EU Member States could help in cross-border cases, as this would ease the handling of the insolvency proceedings and eliminate the – sometimes arbitrary – differences in treatment of assets and parties involved.

1.4.3 Relevant treaties or case law

These matters are discussed above.

1.4.4 Upcoming new legislation

There is no upcoming legislation regarding these issues.

[23] Recast Brussels Regulation, art 4(1).
[24] *Idem*, art 8(1).
[25] EIR Recast, art 7.

2. Substantive consolidated restructuring proceedings versus synthetic group restructurings

As discussed above in section 1, if certain strict criteria are met, case law allows substantive consolidation of bankruptcy proceedings of group companies. If these criteria are not met, a less far-reaching form of procedural consolidation often occurs: consolidation of the liquidation costs. There is some variety in the extent of this type of consolidation. For example, in the bankruptcy of Kroymans B.V. and its subsidiaries, all costs were consolidated; whereas in the bankruptcy of Phanos N.V. and its subsidiaries, the group companies were arranged in different categories of business activity (such as a group of "general companies", "real estate companies" and "asset management companies"). The costs are consolidated per sub-group of companies, thus differentiating by business activity.

With regard to the liquidation costs, the insolvencies of the group companies are considered as one. For any liability other than the liquidation costs, the bankruptcies are treated as single bankruptcies. Therefore, the only consequence of the consolidation of the liquidation costs for the creditors is that the liquidation costs are borne fairly by the estates of all group companies, instead of the costs bearing down on one or more group companies in an arbitrary way. In this way, a synthetic consolidation occurs. We are not aware of more far-reaching types of synthetic consolidation.

The most important obstacle for synthetic consolidation is that the starting point under Dutch law is that every company has its own separate assets and liabilities. A company has its own legal capacity and bears its own rights and duties. This starting point is also the basis of the DBA. The consolidation of insolvency proceedings goes against this basic principle. Dutch law presumes that a stakeholder / creditor engages with a certain company based on the determination of their own position relating to that specific company and its equity position. In case of (synthetic) consolidation, a stakeholder is suddenly confronted with parties and liabilities originating from other companies. This can have a substantial influence on the stakeholder's position, while the stakeholder concerned could not have foreseen this circumstance at the start of the relationship with the company. It could mean that a creditor, whose claim against a group company was well covered by the company's assets, suddenly finds itself without recourse because the company's estate is commingled with the estate of totally insolvent group members, and the creditor has to share "his" or "her" company's assets with creditors of other group companies. The aforementioned starting point of Dutch law and the potentially very negative consequences of (synthetic) consolidation for stakeholders or stakeholder groups, in addition to the lack of clear and undisputable criteria for determination when consolidation should occur, are the main obstacles for (synthetic) consolidation in the Netherlands.

3. Duty to initiate insolvency process

Dutch law has no obligation for a company or its directors to file for bankruptcy, so there are no examples available in relation to how a guarantee provided by a foreign IP would impact on that obligation.

4. Legal certainty and predictability

These issues do not arise under Dutch law as Dutch law has no obligation for a company or its directors to file for bankruptcy.

5. Consolidation of assets

5.1 Procedure with respect to the sale of the whole or part of a business

The WHOA provides for a debtor-in-possession procedure and does not contain any rules on asset sale. In regard to Dutch bankruptcy proceedings, the IP is charged with the administration and liquidation of the bankruptcy estate. As part of the liquidation process, the IP will sell the company's business and assets. The IP is authorised to conduct a public sale. However, the IP requires the consent of the supervisory judge for a private sale.[26] If a formal creditors' committee is installed, the IP needs to consult the committee on the intended sale. However, the advice of the committee is not binding for the IP. There is no difference in the sale process in case of single or consolidated insolvency proceedings, as in both cases the IP will have the same legal powers.

5.2 Difference in treatment with respect to tangible and intangible assets

If two or more insolvency proceedings are fully – substantively – consolidated, all assets and liabilities are commingled into one bankruptcy estate. No difference will be made between tangible and intangible assets.

If only the liquidation costs are – procedurally – consolidated, a difference is possible. For example, if one group company is party to the lease contract but all group companies use the real estate, the costs incurred for the termination of this lease, and the vacation and transfer of the real estate, cannot be allocated solely to the lessee. Those costs have to be borne by all group companies so consolidation of costs relating to the lease is obvious. If all other assets can be allocated to specific group companies, no further consolidation is needed; assets may be treated differently, but that difference is based on the allocation of the asset, or its liquidation costs to each group company, and not based on the type of asset.

5.3 Role of creditors and creditors' committees in a substantive consolidation

As there is no legal basis for consolidation of bankruptcy proceedings, a legal provision for a competent authority to allow for consolidation is lacking as well. In *Re Infotheek*,[27] the court held that the decision of the supervisory judge to allow for consolidation was within the supervisory judge's competence. The questions raised by one of the creditors on the competence of the supervisory judge were rejected by the court. In *Re Van Boven q.q. / Leenhouts' Aannemingsbedrijf*[28] the court explicitly held that a supervisory judge has the competence to allow for consolidation.[29] The creditors and the creditors' committee have no authority with

[26] Such consent is not required if the value of the goods subject to the private sale do not exceed EUR 2,000 (art 101(2) in conjunction with art 176(1) of the DBA).
[27] District Court The Hague 27 December 1995, JOR 1996/87 (*Infotheek*).
[28] Court of Appeal The Hague 22 November 2011, ECLI:NL:GHGR:2011:BU8621 (*Van Boven q.q./Leenhouts' Aanemingsbedrijf*).
[29] Because of the far-reaching consequences of substantive consolidation, a preliminary draft for a recast of the DBA in 2007 suggested that, instead of supervisory judges, district courts would be

regard to the allowance of consolidation. However, creditors and a creditors' committee have a statutory right to approach the supervisory judge in order to challenge any action from the IP, or invoke an order from the supervisory judge to the IP. Even though we are not familiar with any case law on this particular matter, we believe the creditors or creditors' committee could use this right in order to influence the supervisory judge's decision on the IP's request for consolidation.

In regard to consolidated WHOA proceedings, the only approval required is that of the group company whose obligations towards the main debtor's creditors are included in the restructuring. Creditors or other parties have no say in this matter.

5.4 Voting for or against a substantive consolidation

As noted above, creditors do not have a voting right with regard to consolidation of bankruptcy proceedings. They can only try to influence the supervisory judge through the use of their statutory right to approach the supervisory judge in order to challenge any action from the IP or invoke an order from the supervisory judge to the IP.

If a creditor's claim has been allowed by the IP, the creditor is eligible to approach the supervisory judge. However, if the creditor approaches the supervisory judge on a matter that is of no relevance to that creditor's interest because the creditor will not receive any distribution at all – regardless of the decision on the consolidation – the creditor's approach to the supervisory judge can be rejected based on lack of interest. This means that a creditor can only object to a substantive consolidation if this would result in a lower distribution to that specific creditor. If a creditor would not receive any distribution regardless of the bankruptcy being consolidated or handled on a standalone basis, the creditor lacks interest, and the creditor's objection would be denied based on that lack of interest.

As for consolidated WHOA proceedings, creditors do not have any way to prevent a consolidation. Their only power is to vote on the restructuring plan or, if the plan has been approved by at least one-in-the-money class or the class where the value breaks and court confirmation is requested, to ask the court not to confirm the plan. However, this will block the entire restructuring and not just prevent the consolidation.

6. Equitable distribution and accountability of IPs

Under Dutch law, if the proceeds of the liquidation of a company are insufficient to pay all debts and no restructuring plan is offered, the legal entity will be dissolved, and its unpaid debts will cease to exist. In such a situation, Dutch law does not allow for a cram down or bail-in in bankruptcy proceedings.

Under the WHOA, creditors and shareholders are placed in different classes in terms of voting. Creditors or shareholders may not be in the same class if their rights at liquidation or after adoption of the restructuring plan will differ so much that their exposure is not comparable. In any case, creditors or shareholders with a different statutory or contractual ranking will be placed in different classes. The plan is subsequently voted on by each class. Approval is obtained only if creditors

competent to allow consolidation. Since this preliminary draft never came into force, supervisory judges remain the competent authority with regard to consolidation.

or shareholders, representing at least two-thirds of the total debt (or in the case of shareholders, subscribed capital) exercising their voting rights within their class vote in favour of the plan. Once the restructuring plan has been approved by at least one in-the-money class of creditors or the class where the value breaks, court-confirmation of the restructuring plan may be sought. The approval of other classes of creditors or shareholders is not required. The court will test several general grounds – all of which are in line with market standard – for refusal of the request *ex officio*. Additionally, specific grounds for refusal may be invoked by creditors or shareholders who, in short, voted against the plan or were unjustly excluded from voting, or from voting in their rightful class. If the court confirms the restructuring plan, it becomes binding on all creditors and shareholders that were eligible to vote, i.e. those who are affected by the restructuring plan, including the out-of-the-money classes. The restructuring plan may include a debt-for-equity swap or any other cram down. The voting system and threshold for requesting court confirmation provides that this cram down can even take the form of a cross-class cramdown.

7. Intercompany claims

7.1 Order of priority

Dutch law does not provide for a general subordination of claims by a parent or affiliated company or a presumption of this. From *re P&O / Curatoren Wind,*[30] it could be argued that the enforcement of an intercompany claim as an ordinary claim could, under very specific circumstances, constitute a wrongful act towards the other creditors or be contrary to good faith. However, an intercompany claim, either secured or unsecured, cannot be deemed subordinated to other claims solely because it has been provided by a parent or affiliate company.

7.2 Concepts that can alter priority

There is no general concept of "re-characterisation" of intercompany debt as equity or "equitable subordination". Under Dutch law, intercompany debt has the same status as all other debt unless the parties agreed otherwise (either secured or subordinated). To change this status, the intercompany debt would have to be qualified as wrongful or contrary to good faith and, instead of monetary compensation for damages, the compensation would be "in kind" by such re-characterisation / equitable subordination.

8. Administering a complex estate in one single consolidated procedure

As noted, substantive consolidation in bankruptcy proceedings has only been allowed in exceptional cases. The only accepted reason for substantive consolidation is that the assets of the companies have been commingled and cannot be attributed to individual entities in a reasonable way. This could also occur within a part of a group of companies, or within more groups within a group. For instance, if a group of companies has two main business activities which are placed in two separate divisions or units, it is conceivable that the assets of the companies in both divisions or units will have been commingled and therefore cannot be attributed to any specific entity in a reasonable way. This could call for

[30] Court of Appeal Arnhem-Leeuwarden 10 March 2015, ECLI:NL:GHARL:2015:1695 (*P&O/Curatoren Wind*).

substantive consolidation of the companies within both divisions or units. In that way, two consolidated group restructurings would take place within one group of companies.

As to WHOA proceedings, the consolidation only affects those group companies that are liable towards the main debtor's creditors for all or some of that main debtor's debt. Typically, this applies to only one or a few group companies. That way, the WHOA restructuring will affect only a limited number of group companies, resulting in a group subject to the restructuring to exist within the group as a whole.

9. Handling an insolvent parent with a healthy subsidiary

Traditionally, a consolidation can only concern companies that have entered insolvency proceedings. A solvent (i.e. not bankrupt) company cannot be included. However, as noted above, the WHOA does allow a solvent group company’s liability towards the insolvent group company’s debtors to be included in the restructuring plan of that insolvent group company without the solvent company entering its own WHOA proceedings.

UNITED ARAB EMIRATES

1. Consolidated group restructurings versus cooperation or coordination procedure

Before considering group-wide restructurings and insolvencies in the United Arab Emirates (UAE), below is a short summary of the legislative framework in the jurisdiction, provided in order to contextualise the responses to the various questions.

- **General**

Federal laws and Emirate-specific laws

The UAE is predominantly a civil law jurisdiction whose Civil Code derives from the Egyptian and French models. From this foundation, various federal-level laws have been enacted governing civil and commercial transactions, contracts and legal procedures. Further, the UAE constitutional laws devolve legislative competencies for certain matters to each Emirate. Accordingly, when considering applicable "UAE laws", the federal-level laws need to be looked at together with the laws of the relevant Emirate. The law (at both federal and Emirate levels) is still developing and is subject to regular change.

Each individual Emirate is permitted to retain its own judicial system. The effect of this is that there are federal courts and Emirate-level courts in the UAE (UAE Courts), and each Emirate has its own judicial system under which it retains separate authority from the federal judicial system. With limited exceptions, legal proceedings (including insolvency proceedings) are therefore initiated at Emirate-level courts, with a system of appeal which ultimately escalates to federal-level courts. In addition, there are quasi-judicial bodies dealing with the resolution of disputes in specified areas of law (such as rental disputes and commercial agency disputes).

There is no system of binding judicial precedent in the UAE, although in practice, lower courts often follow judgments issued by higher courts. There is also no formal system of case reporting which means that prior judicial decisions may not be publicly available (including to other courts).

Free zones

There are also a number of free zones established within the UAE. These include financial free zones which, by virtue of special federal laws, are exempt from UAE commercial and civil laws. There are currently two financial free zones: the Dubai International Financial Centre (DIFC) and the Abu Dhabi Global Market (ADGM), both of which operate as common law jurisdictions based, to differing extents, on English common law principles.

Laws, regulations and insolvency regimes in the free zones often differ from those that apply in the remainder of the UAE, but only a handful of free zones (such as the DIFC and the ADGM) have their own insolvency laws. Generally, where a matter is not provided for in the law of a free zone, UAE federal law would apply. The DIFC and the ADGM each have their own independent court system to hear civil cases. The DIFC and the ADGM courts are subject to separate laws and procedural rules from the other UAE Courts.

- **Insolvency law – overview**

Federal law

A new federal bankruptcy law in the UAE was published in the Official Gazette on 29 September 2016 as Federal Law No 9 of 2016 and came into force at the end of December 2016 (Federal Insolvency Law). The Federal Insolvency Law was issued in Arabic, and there is no official translation (although the Ministry of Finance has published an unofficial translation on its website). The Federal Insolvency Law may in due course be complemented by additional implementing regulations, but at this stage no supporting regulations have been published, other than a resolution regarding the Financial Restructuring Committee (as to which, see below).

In addition, three amendments to the Federal Insolvency Law have been published. The first (Federal Decree Law No. 23 of 2019 Amending Some Provisions of Federal Decree Law No. 9 of 2016 on Bankruptcy) came into force in 2019, the second (Federal Decree Law Amending Certain Provisions of Federal Decree Law No. 9 of 2016 on Bankruptcy) came into force in 2020, and the third (Federal Decree by Law No. 35 of 2021 Amending Certain Provisions of Federal Decree by Law No. 9 of 2016 on Bankruptcy) came into force in 2021.

The Federal Insolvency Law is stated to apply to:

- companies governed by the provisions of the commercial companies legislation;
- "decree companies" who "opt in" to the Federal Insolvency Law;[1]
- certain free zone entities (as to which see below);
- traders; and
- licensed civil companies or establishments which carry on professional business.

In recent years, a number of insolvency filings have been made under the Federal Insolvency Law but few have seen restructuring plans implemented under those insolvency proceedings. In addition, it seems that fewer than 10 insolvency filings were made under the previous insolvency regime. There has never been a major corporate insolvency in the UAE, save with respect to the restructuring of the Dubai World Group, whose restructuring was partially implemented through the Decree 57 process discussed further below.

Most large-scale group-wide restructurings have been implemented via informal out-of-court arrangements, without recourse to bankruptcy law, although often with reference to INSOL Informal Workout Principles. As a result, the Federal

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[1] "Decree companies" are typically established by decrees issued by a ruler of an Emirate and are relatively common in the UAE. The Federal Insolvency Law provides that companies which are not established under the legislation applicable to commercial companies, are wholly or partially owned by the federal or local government and which "opt in" will be subject to the Federal Insolvency Law. It is not clear whether the Federal Insolvency Law applies to entities established by decree which are nonetheless subject to the provisions of the legislation applicable to commercial companies, of which there are some examples.

Insolvency Law is relatively untested. The recent insolvency filings that have been made, including in respect of Arabtec Holding, KBBO and others, are still working their way through the Courts. Although they may well in time generate valuable insights regarding the application and interpretation of the Federal Insolvency Law, at this stage it is difficult to say with certainty how it would be interpreted or applied.

Free zones

The Federal Insolvency Law applies to a number of different types of entity, including entities incorporated in free zones which do not have their own comprehensive insolvency / restructuring laws. As noted above, the DIFC and the ADGM have their own insolvency laws, which are based on English common law principles and are therefore excluded from the scope of the Federal Insolvency Law, although the position in some of the other free zones is less clear. In the DMCC free zone, for example, certain additional insolvency proceedings are available for companies incorporated in the DMCC. This chapter does not consider the insolvency regimes within the separate free zones or within the DIFC or the ADGM.

Other

In the UAE, there is also the possibility of government intervention in cases where the nature of the debtor is such that its insolvency could have a material effect on the economy (for example, a utility company, bank or airline), and the government has also, in certain isolated cases, passed emergency legislation to set up special committees to deal with the insolvency of high-profile companies such as financial institutions or investment companies. For example, Decree No 57 for 2009 Establishing a Tribunal to Decide the Disputes Related to the Settlement of the Financial Position of Dubai World and its Subsidiaries (Decree 57) provided a separate insolvency framework for Dubai World and its subsidiaries, drawing upon English and United States insolvency law principles. It represented a significant departure from the federal UAE insolvency law in place at the time (and, indeed, from the new Federal Insolvency Law). Decree 57 is only concerned with Dubai World and its subsidiaries, so does not have wider applicability.[2] These factors all contribute to the difficulty of assessing the impact of an insolvency scenario and, as noted above, aside from Decree 57, large-scale restructurings in the UAE have generally been concluded outside the legislative framework.

This chapter considers the restructuring of groups in: (i) insolvency / bankruptcy procedures; and (ii) restructuring / debt-adjustment proceedings under the Federal Insolvency Law. It does not cover insolvency or liquidation regimes in the DIFC or the ADGM or any other free zone, or the insolvency or liquidation regimes applicable to regulated entities.[3]

[2] Decree 57 has now been repealed pursuant to Decree No. 20 of 2022 on Cancelling the Judicial Committee for the Settlement of the Financial Position of Dubai World and its Subsidiaries.

[3] Banks, investment banks and insurance companies are also subject to separate legal and regulatory regimes, which can impact the process that applies in the event of insolvency.

Federal Insolvency Law – background

The Federal Insolvency Law offers two court-based procedures:

- a court-based debtor-led "protective composition procedure" (PCP), designed to be used by a company which is in financial difficulties but is not yet technically insolvent (similar to a French *sauvegarde*); and

- formal bankruptcy, which itself comprises a rescue procedure within bankruptcy or liquidation.

The Federal Insolvency Law also introduced the concept of a "Financial Restructuring Committee", which has now been formally established pursuant to a Cabinet Resolution (No 4 of 2018). The Financial Restructuring Committee will primarily be responsible for:

- overseeing the implementation of the Federal Insolvency Law and reporting back to the Minister of Finance;

- managing the various registers contemplated under that law, such as the roll of industry experts (insolvency professionals potentially from private practice) – which will assist the courts with the various restructuring and insolvency procedures contained within the Federal Insolvency Law – and the public registers which will capture details of insolvent companies and disqualified directors; and

- supervising out-of-court restructuring processes for licensed institutions.

Group-wide restructurings and insolvencies

There are no detailed provisions in the Federal Insolvency Law relating to or providing for consolidated group-wide restructurings or insolvencies, although there are a number of provisions which suggest that a "group-wide" approach to restructuring or bankruptcy is within the contemplation of the legislators.

First, in order to enter a formal restructuring or insolvency process under the Federal Insolvency Law, a corporate debtor must submit a shareholders' resolution, and therefore, in a corporate context, "parent" involvement would be required in any insolvency application. Note, though, that a shareholder of a company that is not a creditor of the company cannot in their individual capacity request a declaration of bankruptcy in respect of the company (although a shareholder that is also a creditor of the company can request such a declaration).[4]

Secondly, the court has the power to join third parties to bankruptcy proceedings if the property of the third parties is so intermingled with the property of the debtor company that the property cannot easily be separated, or if the court considers it to be inefficient from a costs perspective to initiate separate proceedings.[5] Any such order must be made on conditions that secure appropriate and adequate protection of the creditors. It is not clear how this might

4 Federal Insolvency Law, art 141.

5 *Idem*, art 80.

operate in a circumstance where different groups of creditors have claims against the individual entities.

In addition, the Federal Insolvency Law appears to empower the court to declare the bankruptcy of all "general partners" of an entity which is in a bankruptcy process where "the liquidation of properties is judged" (which suggests this applies only where an insolvent liquidation is implemented, rather than in the context of a restructuring in bankruptcy).[6] Although "general partners" is not a defined term in the Federal Insolvency Law, it is likely that this relates to certain partners in partnership vehicles which are jointly and severally liable for the vehicle's debts under the provisions of the commercial companies legislation.[7] In this context, the court supervising the bankruptcy of the debtor entity is also empowered to declare the bankruptcy of the "general partners", even if that court is not competent to declare the bankruptcy of those partners. However, the partners will have separate trustee / insolvency office holders and their bankruptcy procedures will remain independent in terms of management, verification of debts and means of completion. This suggests the possibility of procedural coherence across group insolvency proceedings, if not procedural consolidation.

The Federal Insolvency Law also appears to confer wide powers on the court to declare, on its own initiative or at the request of any interested party, the bankruptcy of every person who undertook in the company's name business for themselves and disposed of the company's properties as if such properties were their own,[8] or to force shareholders to contribute their equity or share capital towards repayment of the debts owed by the bankrupt company.[9]

Although it is not an express feature of its current remit, it is further possible that the Financial Restructuring Committee may encourage coherence across procedures involving group companies by, for example, encouraging communication between officeholders and potentially the appointment of the same officeholders to different group entities (subject to any conflict issues).

However, the scope of these provisions is unclear and untested, and it is not certain that it would result in a consolidation of assets or a group-wide proceeding. Further, in the Arabtec insolvency proceedings which were recently opened in the UAE Courts, seven group entities filed for insolvency proceedings, and a different trustee has been appointed to oversee the insolvency of each one, although one trustee was appointed as a chair of the trustees.

From a cross-border perspective, the author is not aware of any formal co-operation arrangements between the UAE and other jurisdictions in the context of restructuring and insolvencies specifically. The UAE has not adopted the United Nations Commission on International Trade Law Model Law on Cross-Border Insolvency (Model Law) and there are no provisions in UAE law for the recognition of insolvency proceedings commenced in other jurisdictions or for cooperation with the courts of other jurisdictions. As a result, it is likely that any cross-border cases would be dealt with under general private international law principles.

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6 *Idem*, art 142.
7 See, for example, art 40 of the Companies Law, which provides that the bankruptcy of the partnership will result in the declaration of the bankruptcy of all partners.
8 Federal Insolvency Law, art 143.
9 *Idem*, art 146.

The UAE has signed treaties or other reciprocal cooperation arrangements with a small number of other jurisdictions (such as the states of the Gulf Cooperation Council for the Arab States of the Gulf, France and India), but their application is generally subject to conditions, and it is not clear if / how they would be applied in an insolvency scenario.

1.1 Corporate group versus individual legal entity

1.1.1 The insolvency and restructuring systems that are in force

As indicated above, the Federal Insolvency Law applies to a broad spectrum of entities, including "traders" and licensed civil companies or establishments which carry on professional business (such as professional consultancies and legal and medical practices). Some provisions of the Federal Insolvency Law indicate that it is contemplated that it could apply to individuals. It is not entirely clear how multiple businesses owned by one sole trader would be treated in a restructuring or insolvency process under the Federal Insolvency Law, although article 80 of the Federal Insolvency Law suggests that consolidated proceedings may be available (including for group companies) if there are practical or costs reasons for consolidating procedures. There is a separate insolvency law applicable for individuals.

1.1.2 Definition of a corporate group

Some (non-insolvency) UAE federal legislation contemplates group-based arrangements. For example, the preparation and filing of group accounts is required under Federal Decree Law No. 32 of 2021 on Commercial Companies (Companies Law). In addition, the Companies Law also provides for the concept of a "holding company" – being a company whose purpose is to hold shares in another corporate entity, manage subsidiaries and so forth – and sets out a procedure pursuant to which a holding company can merge with affiliate companies, or affiliate companies of a holding company can merge.

However, the Companies Law provides that affiliates of holding companies will be separate corporate persons and will have a financial liability that is independent from the holding company.[10]

1.1.3 Legislation relating to corporate groups

Beyond that set out above, the author is not aware of any draft company or insolvency laws which would provide for a group concept in an insolvency context.

1.2 Corporate group versus individual corporate benefit

Whereas most corporate laws provide for one single entity, one corporate purpose and one corporate benefit, the reality seems to have moved away from the theory. For example, in the case of upstream guarantees, there exists a rule of thumb in practice that the guarantee provided by the subsidiary should not exceed 75% (in the case of an entity with employees) or 90% (in the case of a holding company) of the net assets of the subsidiary.

[10] Companies Law, art 21(4).

1.2.1 *The existence and relevance of "corporate group benefits"*

There is no express concept of corporate group benefit under UAE federal law. Directors of UAE companies are subject to a number of duties. In particular, a director is required to, among other things, consider the interests of the company when voting on resolutions or else the resolutions will be deemed void, and directors must act with the care of a "prudent person" in doing so.

A director who has an individual common or conflicting interest with a transaction being (or to be) undertaken by a company must also disclose the conflict to the board and will be prevented from voting on resolutions related to that transaction.

Although the duty is defined by reference to the company itself, and specifically contemplates that resolutions which bring a special benefit to related parties or others "without consideration of the interest of the company" will be invalid,[11] it does not preclude companies from taking actions which do bring a special benefit to related parties, as long as they consider the interests of the company itself in doing so and any relevant conflicts have been properly disclosed.

Indeed, companies often approach the assessment of whether a particular action is in the "interests" of a company by reference to the wider group matrix – for example, a company can guarantee the financial indebtedness of another group company if there are good commercial reasons for doing so, and that assessment is frequently made by reference to a wider group benefit which in turn will benefit the company.

Pursuant to article 144 of the Federal Insolvency Law, where a bankrupt company's assets are insufficient to settle at least 20% of its debts, the court can order any of the board of directors or the managers of the company to pay the balance of the debts when it is proven that any of them committed certain prescribed acts:

- adopting commercial methods without considering the risks;
- engaging in transactions with third parties to dispose of properties without sufficient consideration; or
- discharging the debts of any creditor to harm other creditors during the period of being in default of payment or in the condition of account receivable.

1.2.2 *Director liability*

Although group companies are not expressly contemplated as being within the scope of directors' duties, directors do, broadly speaking, owe their duties to the company, the creditors of the company and other third parties, which could include group companies.

1.2.3 *"Early warning systems"*

UAE federal law contains similar "early warning" provisions in respect of public and private joint stock companies (JSCs) and limited liability companies (LLCs).[12] Under the Companies Law, if the losses of a JSC or LLC reach 50% or more of its issued share

[11] *Idem*, art 172(1).
[12] *Idem*, arts 308 and 309.

capital, the managers / board of directors must invite the general meeting of the company to convene to pass a special resolution on the continuation / dissolution of the company.

In the case of JSCs, if the general meeting fails to issue a decision, any person concerned may file a claim before the competent court requesting the dissolution of the company. In the case of LLCs, if losses amount to three-quarters of the capital of the company, shareholders holding 25% of the capital of the company can request the dissolution of the company.

The Companies Law sets out a framework for managing the general meeting for JSCs. If the board of directors recommends the continuation of activity of the company's activity, they must provide an auditors' report to the shareholders as well as an approved restructuring including a feasibility study, debt settlement plan and timetable. The company can also nominate a financial consultant to implement the plan with the approval of the Securities and Commodities Authority. If the board of directors recommends the dissolution and liquidation of the company, they must provide an auditors' report together with a liquidation plan and timeline, as well as nominating the liquidators.

1.2.4 Pending or draft legislation

The author is not aware of any pending or draft legislation which exists to deal with this issue.

1.3 Universalism versus territorial principle

1.3.1 Application of the modified universalism rules

In the event of cross-border restructurings or insolvencies, there is no requirement on the federal courts to apply the modified universalism rules as applied by the European Regulations (EC) No 1346/2000 and (EU) 2015/848 on insolvency proceedings.

1.3.2 Bilateral and / or multilateral treaties in force

Insofar as the author is aware, the UAE is not a party to any international insolvency treaties specific to insolvency or restructuring, and the UAE has not adopted the Model Law. Accordingly, there are no insolvency / restructuring-specific legislative provisions which would allow for cooperation with the courts or officeholders in other jurisdictions, or, indeed, the recognition of insolvency proceedings in those jurisdictions.

The UAE does have some reciprocal arrangements in relation to the recognition of judgments from foreign courts, which could in principle apply to insolvency proceedings. However, in most scenarios, recognition would be far from certain. In addition, the UAE Courts will generally claim jurisdiction in respect of any matter involving UAE parties.

Accordingly, there is no certainty that the courts would permit the opening of ancillary proceedings in other jurisdictions.

However, note that, in July 2006, the UAE ratified its accession to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, more commonly known as the New York Convention. Although this will not be of direct relevance in the context of insolvency proceedings, it does provide a potential limited gateway to the enforcement of foreign debts in the UAE.

1.3.3 Pending legislation

The author is not aware of any changes in the federal legislation being envisaged in the near future. However, the new insolvency regulations introduced in the ADGM and the DIFC do incorporate the Model Law. While this remains relatively untested (and its application is subject to conditions), this represents a significant development in the jurisdiction and may prompt other legislative jurisdictions to follow a similar approach.

1.4 Competent court and applicable law

The Federal Insolvency Law does not include the concept of a "centre of main interests". As noted above, the Federal Insolvency Law will apply to: (i) companies governed by the provisions of the legislation applicable to commercial companies; (ii) decree companies who opt-in to the Federal Insolvency Law; (iii) certain free-zone entities where the relevant free zone does not have comprehensive insolvency legislation; (iv) traders; and (v) licensed civil companies or establishments which carry on professional business.

It is possible that the reference to companies governed by the provisions of the legislation applicable to commercial companies is wide enough to mean that a foreign company with a registered presence in the UAE could be subject to the federal insolvency regime in the UAE. This is on the basis that, under the Companies Law, foreign companies have to register on the foreign companies register if they are to conduct business in the UAE, and, subject to certain exceptions, foreign companies conducting business in the UAE will be subject to the provisions of the Companies Law (except those relating to the incorporation of companies).[13] However, this is untested.

The appropriate court for filing an application for a restructuring or insolvency process in the UAE is the competent court for that particular company as set out in Federal Law No 11 of 1992 (Civil Procedures Law). Article 35 of the Civil Procedures Law provides that jurisdiction over claims relating to commercial bankruptcy will be vested in the court in whose area the business premises of the bankrupt are located and, if the bankrupt has more than one place of business, then in the court whose area the bankrupt has adopted as its principal place of business. Claims arising out of bankruptcy must be brought before the court that has made an order declaring the bankruptcy. However, as noted above, in circumstances where a company has entered into bankruptcy and the bankruptcy of all "general partners" has been declared, the competent court in respect of the original debtor company will deliver one judgment of bankruptcy in respect of all general partners, even if the court is not competent to declare the bankruptcy of those partners.[14]

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[13] *Idem*, arts 335 to 337.
[14] Federal Insolvency Law, art 142(s).

1.4.1 *Applicable law that falls outside of the lex fori concursus and related issues*

As noted above, the UAE Courts will generally claim jurisdiction in respect of any matter involving UAE parties, and the Federal Insolvency Law does not give scope for the application of the laws of any other jurisdiction in respect of a company which has entered a restructuring or insolvency process in the UAE under the Federal Insolvency Law.

1.4.2 *Harmonisation of substantive restructuring and insolvency laws*

Harmonisation of substantive restructuring and insolvency laws would certainly help in cross-border cases by giving greater certainty over potential outcomes for debtors and creditors alike.

1.4.3 *Applicable treaties and case law*

As noted above, the UAE is not a party to any international insolvency treaties specific to insolvency or restructuring, and the UAE has not adopted the Model Law.

1.4.4 *Upcoming new legislation*

The author is not aware of any changes in the federal legislation being envisaged in the near future.

2. Substantive consolidated restructuring proceedings versus synthetic group restructurings

Given the untested nature of the Federal Insolvency Law, it is difficult to say with any certainty whether synthetic consolidated group restructuring proceedings would be possible in the UAE. In wholly onshore groups (i.e. not involving companies in any other overseas territory or in any free zones within the UAE), it may in principle be possible, but much will depend on how restructuring or insolvency proceedings under the Federal Insolvency Law are managed in practice, as well as the function and activity of the Financial Restructuring Committee. In groups which include overseas or "offshore" companies, the legislative framework is underdeveloped, and at this stage a synthetic consolidated group restructuring or insolvency with cross-border elements seems challenging. It is possible that, following the introduction of the Federal Insolvency Law at the end of 2016, further implementing legislation may provide further opportunity for development in this area, but no such supporting regulations have yet been introduced.

3. Duty to initiate insolvency process

Under the Federal Insolvency Law, a debtor must file for bankruptcy proceedings if it has been: (i) in a state of "cessation of payments" of due and payable debts; or (ii) a state of "over-indebtedness", in either case for 30 consecutive business days.[15]

The precise scope of the test is unclear and, as with the rest of the Federal Insolvency Law, its application and interpretation are untested.

[15] Following the implementation of the 2021 Decree introduced in the context of the Covid-19 pandemic, these provisions can be relaxed in an "emergency financial crisis".

It is therefore difficult to say whether there would be sufficient legal basis not to open a bankruptcy or PCP on the basis that the directors obtained guarantees from an insolvency practitioner (IP) in another country.

It is also worth noting that failure to file for bankruptcy proceedings within the stipulated time period may be a ground for disqualification from acting as a director of a company. The Federal Insolvency Law contemplates that director disqualification can last for a period of up to five years from the completion of the insolvency process. Under the insolvency regime in place in the UAE prior to the introduction of the Federal Insolvency Law, such a failure could also confer criminal liability on directors, including potential imprisonment. The Federal Insolvency Law purports to decriminalise this by repealing the relevant provisions of the UAE Federal Penal Code (Law 3 of 1987) (as amended) (Penal Code).[16]

However, the Penal Code was amended at a similar time to the introduction of the Federal Insolvency Law pursuant to the Federal Decree-by-Law No 7 of 2016, which: (i) restated provisions of certain insolvency-related provisions in the Penal Code expressed to be repealed by the Federal Insolvency Law; and (ii) while repealing certain other provisions of the Penal Code, did not repeal the remaining provisions expressed to be repealed under the Federal Insolvency Law. The resulting tension between the provisions of the Penal Code and the Federal Insolvency Law mean that the possibility of criminal sanction for failing to file in the specified time limit cannot be discounted.

However, given that, as noted above, the UAE does not appear to be party to any international insolvency or restructuring treaties or other cooperation arrangements, regardless of how the insolvency filing test will be applied or interpreted, the author does not consider that there would be sufficient legal basis in the UAE not to open a bankruptcy or restructuring proceeding on the basis that the directors obtained guarantees from an IP in another country.

4. Legal certainty and predictability

These issues do not arise under UAE law given the unlikelihood that there would be sufficient legal basis in the UAE not to open a bankruptcy or restructuring proceeding in reliance on the directors obtaining guarantees from an IP in another country.

5. Consolidation of assets

5.1 Procedure with respect to the sale of the whole or part of a business

An insolvency officeholder appointed in the context of a bankruptcy under the Federal Insolvency Law has a general power of sale. In the event that a restructuring or rescue within bankruptcy proposal contemplates a sale of the whole or part of the business, this would require the approval of a majority representing two thirds by value of creditors for each proceeding. Such approval would not, however, be binding on secured creditors.

The limited "consolidation" provisions contained within the Federal Insolvency Law do not appear to require the approval of the creditors, although the relevant court order

[16] Federal Insolvency Law, art 230.

must be made on such conditions that secure appropriate and adequate protection of the creditors.

To the extent consolidation is available, there is no specific indication in the Federal Insolvency Law on matters of asset segregation of the insolvent entity, although article 80 would appear to contemplate the possibility of a court being able to join third parties to bankruptcy proceedings if the property of such third parties is intermingled with the property of the insolvent entity in a manner which cannot be separated.

5.2 Difference in treatment with respect to tangible and intangible assets

There is no further guidance on the interpretation of article 80, although, in relation to dematerialised securities (such as equities, bonds or sukuks) which are registered in a UAE central securities depositary (CSD), even though the UAE regulators contemplate the existence of omnibus custodies or brokerage accounts for investors, the author understands that omnibus accounts are relatively uncommon as the ownership of securities in a CSD has to be attributable to each individual investor and therefore registered to that investor's national investor number with the CSD. From experience of securities in the UAE, the author would expect that there is a high likelihood that an insolvency officer or the custodian / broker of the insolvent entity would involve the UAE regulator if questions of asset ownership of the insolvent entity were to arise.

5.3 Role of creditors and creditors' committees in a substantive consolidation

The ability to consolidate assets in a bankruptcy under the Federal Insolvency Law appears to be at the discretion of the court. Although the Federal Insolvency Law does contemplate the establishment of creditors' committees, it is not clear that they would have a formal role in any such consolidation decision. If the consolidation was implemented as part of a restructuring scheme or bankruptcy proposal, the approach would require the approval of a majority representing two thirds by value of creditors for each proceeding. The approval of such a proposal would not be binding on secured creditors.

5.4 Voting for or against a substantive consolidation

There is no indication that creditors would be required to vote on a substantive consolidation arrangement – rather, the limited provision appears to make such consolidation at the discretion of the court.

6. Equitable distribution and accountability of IPs

The Federal Insolvency Law expressly contemplates that schemes proposed in a PCP or restructuring in bankruptcy could include the conversion of debt into equity.[17] As noted above, each scheme proposed under a PCP or restructuring in bankruptcy would require the approval of a majority representing two thirds by value of creditors for each proceeding. Such approval would not, however, be binding on secured creditors.

There are a number of other impediments to restructuring solutions involving debt-for-equity swaps in the UAE. In particular, foreign ownership restrictions can make the implementation of debt-for-equity swaps challenging for international creditors, and

[17] *Idem*, arts 40 and 101.

similarly the requirement for assets to be *Shariah*-compliant can present issues for Islamic institutions.

7. Intercompany claims

7.1 Order of priority

As noted above, article 141 of the Federal Insolvency Law provides that a creditor of the company can request a declaration of bankruptcy of a company even if the creditor is a shareholder in the company, but a shareholder cannot make any such request in his or her individual capacity.

There is no presumption of the ranking of debt between parent or affiliate companies and the debtor company under the Federal Insolvency Law. It is not clear whether contractual subordination provisions between two parties would be recognised, although such contractual arrangements are relatively common in the market.

7.2 Concepts that can alter priority

There is no concept of "equitable subordination" or the "recharacterisation" of intercompany debt as equity under federal law.

8. Administering a complex estate in one single consolidated procedure

As noted above, while there is no group concept in the Federal Insolvency Law, it does appear to give the court the power to join third parties to bankruptcy proceedings if the property of those third parties is so intermingled with the property of the debtor company that they cannot easily be separated, or if the court considers it to be inefficient from a costs perspective to initiate separate proceedings.[18] This suggests that, in a situation where the estate of a debtor is too complex to administer in one single consolidated procedure, it may be possible to consolidate proceedings. However, as the Federal Insolvency Law is new and untested, it is difficult to know with certainty how such a situation might be treated.

Similarly, as noted above, in the context of the Dubai World Group restructuring, a decree was specifically passed in order to facilitate the restructuring of the Dubai World Group. Accordingly, it is possible that, in the event that there was a large-scale insolvency of a debtor group which was too complex to administer in one single consolidated procedure, a similar decree or other law could be issued to facilitate the process.

9. Handling an insolvent parent with a healthy subsidiary

There is no specific mechanism under the Federal Insolvency Law which would allow a solvent subsidiary to be consolidated within an insolvent group proceeding where the entities were all in the same enterprise group. Any intra-group contributions in an insolvency scenario would be as a result of contractual arrangements between separate legal entities (e.g. the provision of guarantees). However, the Federal Insolvency Law is untested.

[18] *Idem*, art 80.

UNITED KINGDOM

1. Consolidated group restructurings versus cooperation or coordination procedure

Consolidated group restructurings are not available under English law, although the current legal structure and system do allow for cooperation among separate legal entities which are subject to insolvency procedures.

In purely domestic matters, where more than one English company in a group is subject to a formal insolvency procedure, this cooperation is done on an *ad hoc* or informal basis and there are no specific provisions within the Insolvency Act 1986 (Insolvency Act) or other domestic legislation which address group cooperation. It would not be uncommon, however, for entities in the same group which are in an insolvency process to have the same or overlapping insolvency practitioners (IPs) serving as administrators or liquidators for related entities. In such a circumstance, the administrators / liquidators are required to treat each group company individually, but the use of the same administrators / liquidators across group companies would facilitate communication, sharing of information (as appropriate) and efficiency.

In cross-border matters, the English court system has various legislative instruments and principles of law that help facilitate cooperation and coordination among separate legal entities in formal insolvency processes. These include:

- the Cross-Border Insolvency Regulations 2006 (CBIR), by which England and Wales have implemented the United Nations Commission on International Trade Law (UNCITRAL) Model Law on Cross-Border Insolvency (Model Law). The Model Law allows for recognition and cooperation of cases pending in foreign jurisdictions; and

- section 426 of the Insolvency Act, which provides for cooperation with certain specified jurisdictions.

In addition, comity, which is the principle that courts will recognise and enforce foreign proceedings subject to certain limited exceptions (i.e. public policy, contravening fundamental standards of procedural fairness, or if there is fraud or unfairness), may be relied upon by courts to provide assistance to foreign courts when the applicable legislation is not available or is not sufficient to address the particular circumstance.

Cross-border protocols dealing with cooperation or coordination could be utilised in a particular case but are not required under English law.

It should be noted that cross-border insolvency cooperation arrangements are now somewhat different in Britain after its membership of the European Union (EU) came to an end – a process which is generally referred to as Brexit. The process led to a formal United Kingdom (UK) / EU withdrawal agreement, the European Union (Withdrawal Agreement) Act 2020 (2020 Act) in the UK, and the UK's formal departure from the EU on 31 January 2020. This was followed by a Brexit implementation period, and this period concluded with the coming into force of a Trade and Co-operation Agreement between the UK and EU on 31 December 2020. This agreement, however, is essentially empty of provisions on judicial cooperation in civil matters.

Under section 3(1) of the UK's European Union (Withdrawal) Act 2018 (2018 Act), direct EU legislation, such as the European Insolvency Regulation (EIR Recast),[1] that was operative immediately before the UK's departure from the EU continued to form part of UK domestic law on and after the exit. Exit day was originally scheduled to be 29 March 2019 but was then extended on two occasions. Under the 2020 Act, the EU withdrawal date was fixed as 31 January 2020. The existing body of EU law, including the EIR Recast, however, remained in force as far as the UK was concerned, until the end of the Brexit implementation period on 31 December 2020 at 11 pm UK time.[2] In the UK 2020 Act, there was a prohibition in section 33 on extending the implementation period.

Sections 8 and 9 of the 2018 Act dealt with the legislative consequences of Brexit. Those provisions effectively conferred a power to deprive "retained" EU law of force and effect. Section 8(1) provided that a minister may make such provision as the minister considers appropriate to prevent, remedy or mitigate: (a) any failure of retained EU law to operate effectively; or (b) any other deficiency in retained EU law arising from the withdrawal of the UK from the EU.

Unless there was some replacement treaty, or other bilateral arrangements, the logic of Brexit suggested that the EIR Recast should cease to apply, as far as the UK is concerned. The UK would then have to rely upon the CBIR / Model Law regime, possibly supplemented by the common law, to govern its relations with other EU countries in respect of insolvency matters. The UK government explains:[3]

> "If the UK continued to apply the [EU] rules unilaterally after exit, the UK's status as a third country would mean that EU countries would not consider the UK to be covered by these rules. As a result, UK citizens, businesses and families would not benefit from these rules. Because of this loss of reciprocity, in the event of a no deal scenario, we would repeal most of the existing civil judicial cooperation rules and instead use the domestic rules which each UK legal system currently applies in relation to non-EU countries. In some specific areas … we would retain elements of the current EU rules, where they either do not rely on reciprocity to operate or where they currently form the basis for our existing domestic or international rules."

The Insolvency (Amendment) (EU Exit) Regulations 2019[4] largely deprive the EIR Recast of continued force and effect in the UK. The UK government, however, places great store in safeguarding legitimate expectations and the security of transactions, and therefore the EIR Recast will continue to apply where main insolvency proceedings had been opened before the completion of the Brexit implementation

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1 Regulation 2015/848 which 'recasts' and replaces Regulation 1346/2000.

2 European Union (Withdrawal Agreement) Act 2020, s 39. "Withdrawal agreement" is defined as the agreement between the UK and the EU under art 50(2) of the Treaty on European Union that sets out the arrangements for the UK's withdrawal from the EU (as that agreement is modified from time to time in accordance with any provision of it).

3 Statement in UK government technical guidance on "Handling civil cases that involve EU countries if there's no Brexit deal", available at: https://www.parliament.uk/globalassets/documents/lords-committees/eu-justice-subcommittee/justiceforfamilies/attachment-2--cjc--insolvency---published.pdf.

4 See also the Insolvency Brexit Regulations SI 2019/146. It should be noted, however, that post-Brexit, the territorial limits on the court's winding-up jurisdiction under s 117(7) of the Insolvency Act 1986 are removed. Moreover, there is now explicit authority in the UK to wind up a company that has either its COMI or an establishment in the UK.

period.[5] In other words, the existing EU rules will still apply to the establishment of jurisdiction and recognition and enforcement of any resulting judicial decision whether or not the decision has been handed down before, or after, the expiry of this period. This exception for pending proceeding means that the EIR Recast will have a long tail since insolvency proceedings can continue for an extended period.

1.1 Corporate group versus individual legal entity

1.1.1 The insolvency and restructuring systems that are in force

There is no concept of a "group" insolvency process under English law. Each company is distinct from its members, and, in insolvency, the separate and distinct legal personality of each individual company within a "corporate group" is respected and the English courts are generally reluctant to "pierce the corporate veil" to make the members or other group companies liable for the debts or the actions of the company.[6]

It should be noted, however, that under the principles of the law of torts, a parent company may under certain circumstances be liable in respect of the actions of a subsidiary company. There are now two leading decisions of the UK Supreme Court in *Lungowe v Vedanta Resources plc*[7] and *Okpabi v Royal Dutch Shell plc*.[8]

However, in these cases, the Supreme Court affirmed that there is no special category of negligence liability for establishing whether a parent company is liable for the activities of its subsidiary. It is to be determined on the basis of ordinary, general principles of the law of torts regarding the imposition of a duty of care. Whether a duty of care arises will depend on the extent to which the parent availed itself of the opportunity to take over, intervene in, control, supervise or advise the management of the relevant operations of the subsidiary. This leaves a degree of uncertainty for parent companies, depending on their corporate structure, group-wide policies and the extent of their involvement in the activities of their subsidiaries.

The Supreme Court said that it would be wrong to make assumptions about any particular corporate group or management structure. There were no limits to the models of management and control that may be put in place within a multinational group of companies. The parent might be a passive investor or, at the other extreme, could carry on management of the group vertically as one commercial undertaking, with legal personality becoming irrelevant.

In order to put a "group" of companies into an insolvency process, separate insolvency proceedings must be commenced in respect of each individual company. However, different forms of insolvency proceedings may apply to each company within the group and, similarly, different IPs may be appointed to each company.

Generally, where companies within an enterprise group[9] are put into insolvency proceedings, as a practical matter, it is common for the same IP to be appointed in

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5 Art 67(3)(c) of the UK / EU withdrawal agreement. See also UK government technical guidance (n 3 above).

6 Where a company is registered as an unlimited company, however, its members will be liable for the debts of the company.

7 [2019] UKSC 20.

8 [2021] UKSC 3.

9 Defined by UNCITRAL Working Group V (Insolvency Law) as "two or more legal entities (group

respect of each company within the group, unless there are conflict issues which would prohibit such appointments. This can help ease the administrative burden of the insolvencies and also reduce the costs of the insolvencies, particularly where there are instances of cross-lending, cross-guarantees and cross-securities among and between the various companies. Notwithstanding that the same IPs may be appointed to all of the companies within the same group, the IPs' duties are still in respect of each individual company to which they are appointed, rather than to the group as a whole; the assets and liabilities of companies are generally not "pooled" for the purpose of distribution to creditors.

1.1.2 Definition of a corporate group

English corporate law does have the concept of a "group undertaking" by reference to definitions of "parent undertaking" and "subsidiary undertaking"[10] within the English Companies Act 2006 (Companies Act). These definitions, along with the slightly more restrictive definitions of "holding company" and "subsidiary",[11] are often incorporated by reference into commercial contracts to provide a definition of a "corporate group". However, in the Companies Act itself, the definitions are generally used, among other things, in the context of preparing the accounts and financial statements of a "corporate group". The definitions of "holding company" and "subsidiary" are also incorporated by reference into the Insolvency Act, but this does not create the concept of a "corporate group" for the purpose of insolvency proceedings.

While there is no concept of a "group insolvency", there are circumstances where the English courts are willing to "pierce the corporate veil" to make a parent company liable for the acts of its subsidiaries. One of these is in the context of pensions. The Pensions Regulator has the power to make third parties (generally a parent or associated companies) liable to provide support or funding to defined benefit pension schemes in certain circumstances. Instances of fraud are another situation where the veil may be pierced, but it is relatively rare that the assets and liabilities of companies within a group will be consolidated. However, in *Re Bank of Credit and Commerce International SA (No 3),*[12] Sir Donald Nicholls VC approved a proposal to pool the assets and liabilities of two companies within the Bank of Credit and Commerce International group because the assets and liabilities of the companies were so "hopelessly intertwined that a pooling of their assets … [was] the only sensible way to proceed".

1.1.3 Legislation relating to corporate groups

Except to the extent already provided, there are currently no draft company or insolvency laws which would provide for a group concept other than the concept of a "group coordination plan" under the EIR Recast.

As explained above, the EIR Recast now only applies to the UK to a very limited extent – specifically, where main insolvency proceedings had already been commenced in a EU Member State before 31 December 2020.

members) that are linked together by some form of control (whether direct or indirect) or ownership" (A/CN.9WG.V/WP.92, 2010, para 2).
[10] Companies Act, ss 1161-1162.
[11] *Idem*, ss 1159-1160.
[12] [1993] BCLC 106.

1.2 Corporate group versus individual corporate benefit

1.2.1 The existence and relevance of "corporate group benefits"

Section 172 of the Companies Act provides that a director must act in the way it considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole.[13] Under current legislation, this duty is limited to the company of which the director is appointed and does not extend to other members of a group.

On 20 March 2018, the Department for Business, Energy and Industrial Strategy published a consultation paper (Consultation Paper)[14] relating to corporate governance and insolvency. The Consultation Paper considered, among other things: (i) if directors of a parent company should be required to consider the interests of a large subsidiary prior to a sale outside of formal insolvency where the subsidiary is in financial difficulty; and (ii) whether stronger corporate governance and transparency measures are required to improve oversight, accountability and internal controls within complex group structures. This proposal has not been taken forward, however.

At present, when determining if an action promotes the "success" of a company, it can, in practice, extend to providing guarantees in favour of related companies. It is generally assumed that, if a parent company provides a downstream guarantee or indemnity for the benefit of one of its subsidiaries, there is adequate corporate benefit to the parent company because the success of the subsidiary will benefit the parent through increased dividends or higher value. In the case of an upstream guarantee, where a subsidiary guarantees or indemnifies the obligations of a parent or sister company, the benefit can be more difficult to substantiate, but can be found based on the particular factual scenario. For example, a parent company may be the borrower on a loan facility which it then on-lends to its subsidiaries, who serve as guarantors, which guarantee would likely be found to provide a benefit to that subsidiary.

Section 172(1) of the Companies Act sets out what a director must have regard to when determining if a transaction will promote the success of a company which includes, among other matters:

- the likely consequences of any decision in the long term;
- the interests of the company's employees;
- the need to foster the company's business relationships with suppliers, customers and others;
- the impact of the company's operations on the community and the environment;
- the desirability of the company maintaining a reputation for high standards of business conduct; and
- the need to act fairly as between the members of the company.

[13] Companies Act, s 172(1).
[14] https://www.gov.uk/government/consultations/insolvency-and-corporate-governance.

When considering the above, a director must exercise the care, skill and diligence which would be exercised by a reasonably diligent person with both the general knowledge, skill and experience that may be reasonably expected of a person carrying out the functions performed by the director in relation to the company, and the general knowledge, skill and experience that the director actually has.[15]

Where the company's purposes, as set out in its articles, consist of or include purposes other than those for the benefit of its members, the director must act in the way it considers, in good faith, would be most likely to achieve those purposes.[16]

This duty is subject to any enactment or rule of law requiring directors in certain circumstances, notably when the company is insolvent or on the verge of insolvency, to consider or act in the interests of the creditors of the company.[17]

1.2.2 Director liability

As noted above, the directors' duties are to the legal entity for which a person acts as a director.[18] When the company is solvent, that means its shareholders; when the company is insolvent or determines that there is no reasonable prospect of avoiding an insolvent liquidation,[19] the duty shifts to the creditors of the company. If a director is found to have acted in breach of its duties, a member of the company may bring an action arising from an actual or proposed act or omission involving (among others) a breach of duty by a director.[20]

Section 178 of the Companies Act provides that the remedies for a breach of the directors' duties set out at sections 171 to 177 of the Companies Act are the same as would apply if the corresponding common law rule or equitable principle applied, with the typical remedies available including an injunction, setting aside the transaction, restitution or accounting of profits or damages.

1.2.3 "Early warning systems"

No early warning systems are required to be in place between directors of individual legal entities and the parent entity under English law.

1.2.4 Pending or draft legislation

There is no pending or draft domestic legislation in relation to these issues.[21]

1.3 Universalism versus territorial principle

1.3.1 Application of the modified universalism rules

The courts of England and Wales would apply the principles of the modified universalism rules for any insolvency or restructuring proceedings commenced in

[15] Companies Act, s 174.
[16] *Idem*, s 172(2).
[17] *Idem*, s 172(3).
[18] Consultation Paper, 2.1.
[19] *Re Ralls Builders Ltd (in liquidation)* [2016] EWHC 243 (Ch)
[20] Companies Act, s 260(3).
[21] Consultation Paper, 2.1.

another state. The courts would look to either section 426 of the Insolvency Act or the CBIR or, alternatively, could rely on common law.

Section 426 of the Insolvency Act provides that courts in England and Wales which have jurisdiction in relation to insolvency law "shall assist the courts having corresponding jurisdiction in any other … relevant country or territory".[22] Notwithstanding the use of the word "shall", the English courts do retain some discretion as to whether they should give assistance, although it is generally viewed that there is a relatively limited basis on which English courts could decline to provide assistance, i.e. if it is against public policy.

The list of "relevant" countries and territories is set out in the Cooperation of Insolvency Courts (Designation of Relevant Countries and Territories) Order 1986 and presently includes 21 countries and territories.[23] The courts in England and Wales may apply, in relation to a specific request, the insolvency law which is applicable either in England and Wales or to the court in the relevant country or jurisdiction. In terms of process, a letter of request must be sent by the foreign court from the relevant jurisdiction and must specify the type of assistance being sought. The types of assistance that can be provided are very broad and have included the appointment of a receiver over assets in England,[24] granting orders permitting the examination of officers of a company[25] and making orders for misfeasance, fraudulent trading, wrongful trading or a transaction at an undervalue under the Insolvency Act.[26] As noted above, this can include looking to the insolvency law of both England and Wales and the foreign jurisdiction.

The CBIR enacts in England and Wales the Model Law adopted by UNCITRAL in 1997. Among other provisions, the CBIR provides for the opening of ancillary proceedings for both foreign main and foreign non-main proceedings.[27]

Alternatively, courts in England and Wales could rely on common law, which is often pleaded as an alternative basis for relief to the CBIR. Practically speaking, common law is only relied upon when none of the statutory frameworks are applicable. The common law principle of comity and universalism was initially exalted per the principles set out in *Cambridge Gas Transport v Official Committee of Unsecured Creditors of Navigator Holdings* (*Cambridge Gas*),[28] but has since been scaled back by the judgments issued by the Supreme Court in *Rubin v Eurofinance SA; New Cap Reinsurance Corp (in liquidation) v Grant* (*Rubin*),[29] and has been further limited by the Privy Counsel's decision in *Singularis Holdings v Pricewaterhouse Coopers* (*Singularis*),[30] where only the concept of modified universalism remained. Each of these decisions are discussed in further detail below.

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[22] Insolvency Act, s 426(4).
[23] The relevant counties and territories are presently: Anguilla; Australia; the Bahamas; Bermuda; Botswana; Canada; the Cayman Islands; the Falkland Islands; Gibraltar; Hong Kong; the Republic of Ireland; Montserrat; New Zealand; St Helena; the Turks and Caicos Islands; Tuvalu; the Virgin Islands; Malaysia; South Africa; Brunei; and Guernsey.
[24] *Re a Debtor, ex parte Viscount of the Royal Court of Jersey* [1981] Ch 384.
[25] *Re Southern Equities (in liquidation), England v Smith* [2000] 2 BCLC 21.
[26] *Re BCCI SA* (No 9) [1994] 3 All ER 764.
[27] CBIR, art 17.
[28] [2006] UKPC 26.
[29] [2013] UKSC 46.
[30] [2014] UKPC 36.

Under the principle of "modified universalism", insolvency proceedings opened in a debtor's "home" jurisdiction should be recognised and given effect in other countries throughout the world. As far as possible, the courts should try to implement a single scheme of distribution applicable to all the debtor's assets. In *Cambridge Gas*,[31] Lord Hoffmann said:

> "The English common law has traditionally taken the view that fairness between creditors requires that, ideally, bankruptcy proceedings should have universal application. There should be a single bankruptcy in which all creditors are entitled and required to prove. No one should have an advantage because he happens to live in a jurisdiction where more of the assets or fewer of the creditors are situated."

More recent decisions, however, have acknowledged the boundaries of judicial creativity and common law judicial assistance, stating that any assistance given is subject to local law and public policy and cannot be used to undermine or usurp local law-making. In the leading decision of the Privy Council in *Singularis,*[32] it was held that while, under the principle of "modified universalism", the court had a common law power to assist foreign insolvency proceedings, the exercise of the power was subject to the constraints of local law and local policy norms. The fact that local law might permit local liquidators to do certain things in the case of a domestic insolvency did not necessarily mean that a foreign liquidator could do the same, or equivalent, things in the absence of statutory authorisation.

In *Rubin*,[33] the UK Supreme Court overturned an English Court of Appeal decision that a monetary default judgment given in United States (US) bankruptcy proceedings could be enforced in England. The defendant was not considered to be "present" in the US, nor had it submitted to the jurisdiction of the US courts. The Court of Appeal had accepted as a general principle of private international law that insolvency law, whether applying to individuals or to corporate entitles, should be unitary and universal. In its view, therefore, there should be unitary insolvency proceedings in a court of the insolvent's domicile that should receive worldwide recognition and also apply to all the insolvent's assets. The Court of Appeal had held that the concept of insolvency proceedings as a *sui generis* category of private international law included transactional avoidance mechanisms. Avoidance proceedings were said to be central to the collective enforcement regime in insolvency and were governed by the special insolvency rules.

The Supreme Court, however, held the Court of Appeal decision in *Rubin* should not be followed because it was not an incremental development of existing principles, but rather a radical departure from substantially settled law. It said that a change in the settled law governing the recognition and enforcement of judgments had all the hallmarks of legislation and was a matter for legislative decision rather than judicial innovation. According to Lord Collins:[34]

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[31] [2006] UKPC 26, [16]-[17]. See also Lord Hoffmann in *Re HIH Casualty and General Insurance Ltd* [2008] UKHL 21, [7], referring to the principle of modified universalism as the "golden thread" running through English cross-border insolvency law since the eighteenth century and in the *Cambridge Gas* case referring to it as an "aspiration".

[32] [2014] UKPC 36, where Lord Neuberger referred at [157] to the "extreme version" of the principle of universality propounded by Lord Hoffmann in *Cambridge Gas*.

[33] Rubin v Eurofinance SA [2013] UKSC 46.

[34] [2013] 1 AC 236, [130].

> "the introduction of judge-made law extending the recognition and enforcement of foreign judgments would be only to the detriment of United Kingdom businesses without any corresponding benefit … a person in England who might have connections with a foreign territory which were only arguably 'sufficient' would have to actively defend foreign proceedings which could result in an *in personam* judgment against him, only because the proceedings are incidental to bankruptcy proceedings in the courts of that territory … [I]t might suggest that foreigners who have bona fide dealings with the United States might have to face the dilemma of the expense of defending enormous claims in the United States or not defending them and being at risk of having a default judgment enforced abroad."

1.3.2 Bilateral and / or multilateral treaties in force

See the discussion of the Model Law and CBIR above and the UNCITRAL Model Law on Enterprise Group Insolvency noted below.

1.3.3 Pending legislation

No immediate changes are envisaged.

1.4 Competent court and applicable law

1.4.1 Applicable law that falls outside of the lex fori concursus and related issues

As detailed above, there is no concept of "group" insolvency under English law. Whether the English courts have jurisdiction in respect of an individual company's insolvency proceedings will depend on whether the conditions necessary to open insolvency proceedings in England are satisfied – a matter that will, in the first instance, be determined by English law.

Broadly, the effect of the Insolvency Brexit Regulations is to give jurisdiction to UK courts to open insolvency proceedings following Brexit, where:

- the proceedings are opened for the purposes of rescue, adjustment of debt, reorganisation or liquidation; and

- the centre of main interests (COMI) of the debtor is in the UK; or the COMI of the debtor is in an EU state and there is an establishment in the UK.

These tests are consistent with the EIR Recast for determining the proper jurisdiction for a debtor's insolvency proceedings and the applicable law to be used in those proceedings. The Insolvency Brexit Regulations go on, however, to say that this jurisdiction will be in addition to any grounds for jurisdiction to open such proceedings which apply in the laws of any part of the UK. This effectively extends the UK court's jurisdiction: (i) to wind up any foreign company which might be wound up as an unregistered company under UK insolvency laws regardless of whether the COMI is in an EU Member State, provided the court considers there to be sufficient connection with the UK; and (ii) to place a company incorporated in a European Economic Area (EEA) state, or having its COMI in an EEA state, into administration in the UK. This gives rise to the possibility of races to open proceedings in competing states.

For proceedings opened under the EIR Recast prior to Brexit completion day, transitional provisions provide that the UK court will continue to apply the terms of the EIR Recast unless the court considers that the interests of a creditor, the debtor, or shareholders of a corporate debtor would be materially prejudiced; or if the court considers it would be manifestly contrary to public policy. The UK courts would then have authority to apply relevant UK law and make any other order they thought fit. According to UK Insolvency Service guidance, this provision is necessary since the EU will no longer afford UK insolvency proceedings recognition on an automatic reciprocal basis.

In recent years, many corporate restructurings in respect of foreign-registered companies have been accomplished by means of a scheme of arrangement under Part 26 of the Companies Act.[35] The scheme is a three-stage process including, at the final stage, an order of the court approving the scheme. It is a form of "debtor-in-possession" restructuring that enables a company to enter into a compromise or arrangement with any class of creditors or members. The restructuring may involve various elements such as an extension of debt repayments, whole or partial debt forgiveness and converting debt into shares or share warrants.

Schemes of arrangement were not listed under the EIR Recast. This means that they were not entitled to the benefits of automatic EU-wide recognition under that regulation. There was, however, somewhat inconclusive case law on whether the court order was a judgment for the purpose of the Jurisdiction and Judgments (Brussels 1) Regulation and therefore qualifying for automatic EU-wide recognition on that basis.

In approving schemes, the UK courts assume a wide jurisdictional base. They may approve a scheme where the relevant foreign company was considered to have a "sufficient connection" with the UK even though the COMI of the company was not in the UK. A sufficient connection is deemed to exist by virtue of the fact that the company's credit facilities contained English choice of law and jurisdiction clauses and also by reason of expert evidence that the relevant foreign courts would recognise the scheme. Forum-shopping issues in relation to schemes were addressed by Snowden J in *Re Van Gansewinkel Groep BV*,[36] who commented:

> "In recent years schemes of arrangement have been increasingly used to restructure the financial obligations of overseas companies that do not have their COMI or an establishment or any significant assets in England … The use of schemes of arrangement in this way has been prompted by an understandable desire to save the companies in question from formal insolvency proceedings which would be destructive of value for creditors and lead to substantial loss of jobs. The inherent flexibility of a scheme of arrangement has proved particularly valuable in such cases …"

The matter was further considered by Newey J in *Re Codere Finance (UK) Ltd*,[37] who distinguished between "good" and "bad" forum shopping. The case had been

[35] See generally L C Ho, "Making and Enforcing International Schemes of Arrangement" (2011) 26 *Journal of International Banking Law and Regulation* 434; J Payne, "Cross-Border Schemes of Arrangement and Forum Shopping" (2013) 14 *European Business Organization Law Review* 563.
[36] [2015] EWHC 2151 (Ch).
[37] [2015] EWHC 3778 (Ch). Note too *Re Algeco Scotsman PIK SA* [2017] EWHC 2236 (Ch) where the court commented that although "forum shopping" had been used as a pejorative description, the company's resort to the English court in the present case was appropriate and understandable

characterised at an earlier stage as "quite an extreme form of forum shopping, in which the restructuring proceedings were brought in the UK purely by incorporating a company to take on very large liabilities." Newey J, however, said that the English courts had become comfortable with exercising the scheme jurisdiction in relation to companies that did not have longstanding connections with England. He recognised that the present case involved forum shopping in that debtors were seeking to give the English court jurisdiction to take advantage of a procedure for confirming schemes which was available in England but not as available in other countries. The judge said:

> "Plainly forum shopping can be undesirable. That can potentially be so, for example, where a debtor seeks to move his COMI with a view to taking advantage of a more favourable bankruptcy regime and so escaping his debts. In cases such as the present, however, what is being attempted is to achieve a position where resort can be had to the law of a particular jurisdiction, not in order to evade debts but rather with a view to achieving the best possible outcome for creditors. If in those circumstances it is appropriate to speak of forum shopping at all, it must be on the basis that there can sometimes be good forum shopping."

The *Corporate Insolvency and Governance Act 2020* introduced a new Part 26A into the Companies Act which makes provision for a new restructuring plan procedure that is modelled upon, but differs somewhat, from the existing scheme of arrangement procedure in Part 26. While the new procedure is only available for companies to address financial difficulties (to be broadly interpreted), the jurisdictional tests are the same for both procedures. The new restructuring plan procedure, however, only requires 75% in value of affected creditors voting in favour, rather than a majority in number also. Moreover, there is provision for cross-class cram down of an affected group of creditors that does not vote in favour of the restructuring plan, if the affected group would receive at least as much under the plan as they would receive in the most realistic alternative scenario if the restructuring plan were not implemented.

1.4.2 Harmonisation of substantive restructuring and insolvency laws

Practitioners have noted that there are many situations where it would be advantageous for the affairs of an insolvent group to be managed under a single insolvency regime through procedural (if not substantive) consolidation of proceedings.[38] There is, however, some flexibility under the EIR Recast and, where companies within a corporate group are determined to all have the same COMI, the courts can make orders to enable the coordination of insolvency procedures by, for example, appointing the same IPs to be joint administrators.[39]

The extent to which English law has the necessary flexibility to assist with cross-border insolvencies was tested in the Lehman Brothers insolvency. In order to assist in dealing with cross-border group insolvencies, the concept of a group protocol has

given the lack of any viable or efficient alternatives. See also *Re Apcoa Parking Holdings GmbH* [2014] EWHC 3849 (Ch) – whenever there is a change in jurisdiction clause for the purpose of opening the gateway to the English scheme jurisdiction, the court should be careful to scrutinise whether the change of law or jurisdiction was inappropriate.

[38] I Fletcher, "Living in Interesting Times – Reflections on the EC Regulation on Insolvency Proceedings – Part 3" (2005) 18 *Insolvency Intelligence* 85.

[39] *Crisscross Telecommunications Group*, Chancery Division, May 20, 2003, unreported.

been adopted by insolvency officeholders in an effort to minimise costs and inefficiencies and maximise the recovery for creditors. An example of this is the Cross-Border Insolvency Protocol for the Lehman Brothers Group of Companies. However, this was not signed by the administrators of a number of English companies in the Lehman group who argued that, while they were in favour of cooperation, English law treats each insolvent entity as a separate entity, and the administrators could not subject themselves to an expensive agreement which would allow the sharing of sensitive information and entangle them in decisions taken by another court. Instead, the administrators signed several bilateral "agreements". Bob Wessels notes, however, that one of the first protocols was entered into by English administrators, in respect of Senod International Ltd,[40] and so the approach of entering into protocols has precedence.

Sir Roy Goode remarks that, outside of EU law, ancillary proceedings and judicial assistance may help to overcome the difficulties caused by the separate legal identities of members of a corporate group, noting the English courts' willingness to provide assistance under section 426 of the Insolvency Act and courts in the United States providing assistance under section 304 of the Bankruptcy Code.[41]

1.4.3 *Relevant treaties or case law*

These matters are discussed above.

1.4.4 *Upcoming new legislation*

As mentioned above, the EIR Recast introduced the concept of a "group coordination plan", included a new chapter aimed at addressing corporate groups and provided a definition of COMI.

Where more than one member of the group is in an insolvency proceeding, the legislation allows an officeholder to request the opening of group coordination proceedings. A "group of companies" is defined as a parent undertaking and its subsidiary undertakings. The group proceeding is voluntary, and officeholders may object to being included as part of the coordination proceedings. Where a company / officeholder has opted in, the officeholder is only required to consider the coordinator's recommendations and the content of the group plan with no obligation on the officeholder to follow the plan. But if an officeholder opts out of the coordination plan, they must provide reasons for opting out. When opening group coordination proceedings, the courts will consider whether any group member might be financially disadvantaged by taking part and whether it is appropriate to proceed with a group plan.

In relation to COMI, the EIR Recast introduced a formal definition: "the place where the debtor conducts the administration of its interests on a regular basis and which is ascertainable by third parties" and "in the case of a company … the place of the registered office shall be presumed to be the centre of its main interests in the absence of proof to the contrary". In an effort to reduce forum shopping, the EIR Recast provides that the presumption regarding the registered office shall only apply

[40] B Wessels, "Cross-Border Insolvency Agreements: What Are They and Are They Here to Stay?" in D Faber and N Vermunt (eds), *Overeenkomst en insolventie* (Deventer, Kluwer, 2012) 359-384.

[41] R Goode, *Principles of Corporate Insolvency Law* (Sweet & Maxwell, 4th ed, 2011) 16-10 (788).

if the registered office has not been moved to another Member State within the three-month period prior to the request for the opening of insolvency proceedings.

As noted, to a large extent, the EIR Recast is no longer part of UK law. It may be that the UK will introduce changes to its domestic insolvency law by implementing the UNCITRAL Model Law on Enterprise Group Insolvency with Guide to Enactment (2019), but this is not likely to happen in the immediate future.

2. Substantive consolidated restructuring proceedings versus synthetic group restructurings

Synthetic consolidated group restructurings could work, although the success of any particular restructuring would depend on the other relevant jurisdictions implicated. As set forth above, there are several established legal bases on which group proceedings could be effectively done on a synthetic basis.

In fact, one of the main thrusts of the EIR Recast is to reduce the circumstances in which secondary proceedings may be opened. The regulation does this by generalising and "Europeanising" some of the practices developed by the English courts in cases like *Re Collins and Aikman*.[42]

In *Re Collins and Aikman*, the court developed the notion of "synthetic" secondary proceedings, holding that the UK Insolvency Act was sufficiently flexible so that UK IPs could honour promises made to creditors in other states that local priorities would be respected in return for not opening secondary proceedings in these states. Local creditors effectively got the benefits of secondary proceedings without the trouble of having to open them. These secondary proceedings were "synthetic" or "virtual" rather than actual.

Re Collins and Aikman confirms the ability of an English court to direct that English administrators should distribute assets to foreign creditors, so far as possible, in accordance with their hypothetical rights under their respective local laws in the event that secondary proceedings had actually been opened in those countries. The fact that the UK has now left the EU does not affect the capacity of English courts to come to imaginative restructuring solutions such as those evidenced in *Re Collins and Aikman*.

With purely domestic groups, it is relatively common to see IPs act as administrators or liquidators for related companies, albeit the individual creditors and claims are treated on an entity-by-entity basis. Although the administrators / liquidators are required under the Insolvency Act to look at the group companies on an entity-by-entity basis, the consistency of the administrators / liquidators across a group of entities generally results in a consistency of approach and a high level of cooperation. Given that England and Wales largely employ out-of-court processes, the administrators / liquidators are generally empowered to take action in line with their duties without needing to obtain court approval or sanction.

In the case of cross-border groups, the legal framework in place in England and Wales would enable a synthetic group restructuring. As noted in the introduction to this chapter, section 426 of the Insolvency Act, the EIR Recast and the CBIR each allow means to effectively cooperate and coordinate proceedings. Furthermore, the CBIR

[42] [2006] EWHC 1343 (Ch).

does not have a reciprocity requirement, meaning that it is not necessary for parallel legislation to be in place in the relevant foreign jurisdiction in order for the CBIR to be utilised in England and Wales to enable recognition and coordination. That is not to say that the ability of IPs and / or courts in England and Wales to cooperate and coordinate proceedings in foreign jurisdiction is not without limits. However, if there is a will and desire to cooperate, the English framework enables a cross-border restructuring to be effectuated.

3. Duty to initiate insolvency process

As mentioned, under current law, directors appointed to English companies have a duty to that company and not to other members of the company group. If a director of an English company is of the view that the company will be unable to satisfy its debts as they fall due, the director's responsibility shifts to the creditors of the company, and the director should commence an insolvency proceeding. Failure to do so could result in personal liability for the director for wrongful trading under section 214 of the Insolvency Act.

In order for the directors of an English company to not place the subject company into an administration or other insolvency process in such a situation, the directors would need to be in a position where they were comfortable that an indemnity / guarantee provided by an IP in another country would be sufficient so that creditors of the company would not be made worse off by the company continuing to trade. The directors would also need to be comfortable that the IP providing the guarantee / indemnity had the power to do so, that such guarantee / indemnity was enforceable and that the IP providing the guarantee had the means to satisfy the obligations under the guarantee / indemnity.

In England, the mere presence of a guarantee / indemnity that could be called on would not of itself be sufficient to prevent creditors from bringing proceedings against the company. Therefore, the benefit to the IP of giving such a guarantee / indemnity to a company on the verge of insolvency would not ensure that the English company would not enter an insolvency process.

4. Legal certainty and predictability

4.1 Legal certainty and predictability to local creditors

As noted above, a foreign IP providing a guarantee / indemnity is not something that we are aware has been done in England and we would query what legal certainty this would provide to local creditors.

If such a guarantee was to be provided, presumably it could be negotiated that local creditors could be advised of its existence and the recourse that the English company would have to that guarantee. The level of confidence that local creditors would take from this would depend on whether the guarantee was secured or unsecured and their confidence in the English company's ability to drawn on such a guarantee / indemnity. Challenges in this regard would likely relate to the local creditors' familiarity with the jurisdiction where the insolvency matter is pending and their confidence that a company in a formal insolvency process can meet such an obligation. It should also be noted that it would be very difficult for English directors to agree not to put an English company into an insolvency process, notwithstanding that they were provided with a guarantee. An English director cannot contract out of its directors' duties and would be under a continuing obligation to assess whether the position of the company had changed such that an insolvency filing was necessary.

4.2 Communications with local courts and creditors

The IP can seek to have the foreign proceeding recognised in England, but such recognition would not prevent a creditor of the English company commencing an insolvency proceeding against the English company if it had grounds to do so. As no proceeding would be pending against the English company at this stage, the courts would likely not be the best means of communication. Instead, this seems to be a situation where it would fall to the English company, with the cooperation of the IP, to alert the creditors of the arrangement and seek to provide them with the necessary assurances that such creditors should not take adverse action against the English company.

4.3 Guarantees by the IP in office

The guarantee would be provided to the directors of the English company and the English company itself and would need to cover all liabilities which arise following the point that the directors would have otherwise determined that they are unable to avoid an insolvent liquidation, such that the creditor position remains neutral.

5. Consolidation of assets

5.1 Procedure with respect to the sale of the whole or part of a business

As discussed, each legal entity would be treated as an independent and separate legal entity from other members of its group. There is no concept in English law which would permit two companies within the same group to consolidate their assets on the basis of obtaining "joint" creditor approval; approval would need to be sought from the relevant creditors of each individual company. Further, as mentioned previously, there is no doctrine of substantive consolidation under English law.

However, it is worth noting that the English court in *Credit and Commerce International SA (No 3)*[43] did permit the consolidation of assets between two group companies where the assets were so intertwined that consolidation was the "only sensible way to proceed". However, in giving his judgment, Sir Donald Nicholls VC noted that this was an "exceptional case" requiring "exceptional treatment".
In respect of administration, it is possible that an administrator appointed to two companies within the same group would look to sell, and thereby consolidate, the assets of those companies to another member of the group. The exercise of the power to dispose of a company's property is one of the main ways in which an administrator achieves the purpose of an administration. Other than in relation to certain sales to connected parties, an administrator is free to enter into a pre-pack sale of the company's assets without consultation with unsecured creditors or direction from the court.[44] An administrator may also dispose of property that is subject to a floating charge without the consent of the relevant secured creditor or the formal release of the charge.[45] An administrator is also entitled to dispose of property subject to a fixed charge without the consent of the relevant secured creditor if they obtain

[43] [1993] BCLC 1490.
[44] *DKLL Solicitors v HMRC* [2007] EWHC 2067 (Ch).
[45] Insolvency Act 1986, sch B1, para 70(1).

the consent of the court to do so.[46] The administrator will apply the net proceeds from the disposal of the property in question towards discharging the obligations of the company to the secured creditor. Shareholder consent for these steps would not be necessary.

A company may be able to enter into a scheme of arrangement whereby its subsidiaries are consolidated or part of the business of the company is sold. Depending on the nature of the proposed scheme, secured creditors (and possibly shareholders) may need to consent to such an arrangement and the company which is the subject of the arrangement is likely to be in communications with its significant stakeholders as to how the scheme should be arranged.

As explained already, a scheme is a statutory procedure under the Companies Act (rather than an insolvency procedure) which permits a company to make an arrangement or compromise with its members and / or creditors (or any class of them) which, if approved by the requisite majority of such members and / or creditors and sanctioned by the court, will be binding on all of them, whether or not they vote in favour of it.

To be a valid scheme there must be a compromise – it is not possible to take away members' / creditors' rights for no consideration. For a scheme of arrangement to be approved, the company subject to the scheme will determine the relevant classes of creditors / shareholders to approve the scheme. At the class meetings, the scheme is approved by the relevant majority of each relevant class, being: (1) a majority in number; and (2) representing three-quarters in value of those present and voting in each relevant class. Following the meeting, the court will consider whether to sanction the scheme based on the fairness of the scheme and whether the classes are properly constituted.

5.2 Difference in treatment with respect to tangible and intangible assets

There is no difference in this regard.

5.3 Role of creditors and creditors' committees in a substantive consolidation

The approval of a creditors' committee is not applicable in this instance. However, approval of secured creditors would be required to affect a sale of assets pursuant to a pre-pack.

5.4 Voting for or against a substantive consolidation

Not applicable.

6. Equitable distribution and accountability of IPs

Under English insolvency law, it is possible to convert debt to equity on a consensual basis, but a "cram down" is not possible. A scheme of arrangement, which is not an insolvency procedure but instead a process under Part 26 of the Companies Act, however, does provide for a means to cram down non-consenting creditors. In a scheme of arrangement, a company may enter into a compromise or arrangement with its creditors, or any class of them. There is no insolvency requirement for schemes

[46] *Idem*, para 71(1).

of arrangement, but they are often used in conjunction with formal insolvency procedures. In a scheme, a company may classify its creditors into one or more classes and propose a compromise or arrangement, which may take any form. Each constituted class has the right to vote on the proposal, which will become subject to court sanction provided that (as noted above) at least 50% in number constituting 75% in value of each relevant class of creditors votes in favour of the scheme of arrangement. A scheme can be limited to specific creditors and, while it, on its own, does not have certain of the advantages available in a formal insolvency proceeding (i.e. a moratorium), it does provide a mechanism for a company to enforce modifications on a minority dissenting group of creditors.

As explained already, it is also possible to cram down creditors, even across classes of creditors, or to convert debt into equity, by means of a restructuring plan under Part 26A of the Companies Act, as introduced by the *Corporate Insolvency and Governance Act 2020*. For the restructuring plan, there is a greater range of restructuring possibilities open given the opportunity for cross-class cram down, and there is no numerosity requirement, although the corporate debtor must be facing financial difficulties.

7. Intercompany claims

7.1 Order of priority

No presumption is made as to the ranking of debt between affiliated parties. The ranking of debt and the extent of subordination between creditors (including affiliates) will depend on the contractual agreement between parent and affiliate and whether there are any inter-creditor or subordination agreements between the parent and the other creditors of the affiliate.

In *Re Maxwell Communications Corp plc (No 2)*,[47] it was held that nothing in a subordination agreement undermined the *pari passu* principle, and, provided they were properly entered into, such agreements should not be deemed invalid.

7.2 Concepts that can alter priority

Under English law there is no concept of "equitable subordination" or the "re-characterisation" of intercompany debt as equity.

8. Administering a complex estate in one single consolidated procedure

The Insolvency Act is clear on how creditors of English companies are treated within an insolvency proceeding and the treatment of creditors cannot be varied such that the waterfall of distributions is disturbed (i.e. all unsecured creditors must be treated *pari passu*). While it is true that, generally speaking, only fixed charge creditors have recourse to the assets subject to their fixed charge up to the amount of their secured debt, there is no ability otherwise under English law to split assets and / or creditors of a legal entity into different groups based on complexity. All unsecured creditors of a company would need to be treated in a like manner, and the same principle would apply against the other classes of creditors.

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[47] [1994] 1 All ER 737.

9. Handling an insolvent parent with a healthy subsidiary

For the reasons detailed above, as there is no concept of a group proceeding, each legal entity would be treated as distinct from the other members of the group. Solvent subsidiaries may be called upon to contribute to the estate of the insolvent parent if they have provided guarantees for the benefit of the parent, but otherwise they would not be called upon to contribute.

UNITED STATES OF AMERICA

1. Consolidated group restructurings versus cooperation or coordination procedure[*]

As a general rule, the United States (US) Bankruptcy Code[1] and US Bankruptcy Rules[2] respect the separateness of each legal entity within a corporate group. A separate petition must be filed for each legal entity within the group (i.e. a debtor) in order for that entity to become the subject of a US bankruptcy case. In turn, a separate US bankruptcy case is opened for each legal entity for which a petition has been filed.[3] Thus, as an example, to place an entire corporate group consisting of 20 affiliated corporate entities into bankruptcy in the United States, 20 petitions would have to be filed, commencing 20 US bankruptcy cases.

However, US bankruptcy cases opened for multiple entities within a single corporate group may be consolidated in two different ways, outlined below.

- **Procedural consolidation (also known as joint administration)**

  Rule 1015 of the US Bankruptcy Rules permits procedural consolidation of the US bankruptcy cases of affiliated entities solely for administrative convenience and efficiency. Joint administration makes it simpler and more cost-effective for debtors and creditors to make, and for US bankruptcy courts to resolve, requests for relief during the cases that impact multiple debtors within the corporate group, for example by consolidating notices, requests for relief and other pleadings from all of the cases onto a single docket.

  Joint administration has *no* substantive impact on the separateness of the entities within a corporate group. The separate assets and liabilities of each debtor (including intercompany claims between members of the corporate group) continue to be recognised and respected.

- **Substantive consolidation**

  In US bankruptcy jurisprudence, "substantive consolidation" refers to a disregard of the corporate separateness between two or more entities within a corporate group, such that their assets are merged together into one common pool to which the creditors of each entity must look to satisfy their claims.[4]

  Although US courts have a long history of granting substantive consolidation under appropriate circumstances, neither the US Bankruptcy Code nor the US

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[1] "US Bankruptcy Code" means Title 11 of the USC, 11 USC §§ 101–1532. The US Bankruptcy Code is the statutory law enacted by the US Congress to govern both domestic and cross-border US bankruptcy cases.

[2] "US Bankruptcy Rules" means the Federal Rules of Bankruptcy Procedure promulgated by the US Supreme Court.

[3] The types of US bankruptcy cases include liquidation cases pursuant to Chapter 7 of the US Bankruptcy Code, reorganisation or structured liquidation cases pursuant to Chapter 11 of the US Bankruptcy Code, and cross border cases pursuant to Chapter 15 of the US Bankruptcy Code.

[4] See *FDIC v Colonial Realty Co*, 966 F2d 57, 58 (2d Cir 1992) (substantive consolidation "effects the combination of the assets and the liabilities of distinct, bankrupt entities and their treatment as if they belonged to a single entity").

Bankruptcy Rules explicitly authorises the bankruptcy estate[5] of one debtor to be substantively consolidated with that of another. As a result, the source of authority and proper legal standard for granting substantive consolidation is the subject of some dispute and courts have not applied the relief uniformly. The authority is generally recognised to have originated in US federal common law and been implicitly embodied within certain provisions of the current US Bankruptcy Code.[6]

In the absence of legislative guidance, a number of different, sometimes overlapping judicial, standards have developed among courts in the various US judicial circuits. Each standard, in its own way, ensures that substantive consolidation is granted sparingly. For example, the standard governing bankruptcy cases in Delaware permits substantive consolidation only upon proof that: (i) prior to bankruptcy creditors extended credit in reliance on the corporate group as a whole, rather than on the separate assets and liabilities of individual members of the group; or (ii) the books, records and financial affairs of members of the corporate group are so commingled that untangling them during the bankruptcy would be costly and leave all creditors worse off.[7]

Neither procedural consolidation nor substantive consolidation is automatic. Thus, even where numerous entities in a large corporate group are placed into bankruptcy, the US bankruptcy case of each member of the group will remain separate unless and until consolidation is requested and granted. In practice, procedural consolidation is sought and granted in the vast majority of all corporate group US bankruptcies. By contrast, substantive consolidation is infrequently requested and, especially if opposed by creditors, is even more infrequently granted.

1.1 Corporate group versus individual legal entity

1.1.1 The insolvency and restructuring systems that are in force

The US Bankruptcy Code generally recognises the separateness and independence of distinct legal entities within a corporate group both from each other and from their common owner-entrepreneur.[8] No member of a corporate group is required to open its own US bankruptcy case solely because other members within the same corporate group have done so. Similarly, no subsidiary member in a corporate group is required to open its own US bankruptcy case solely because its parent company or controlling shareholder has done so, and *vice versa*.

Moreover, absent substantive consolidation and with limited exceptions discussed below, the US Bankruptcy Code permits one corporate group member – whether or not itself a debtor subject to its own US bankruptcy case – to participate in the US

5 Upon the filing of a petition commencing a plenary US bankruptcy case (e.g. a Chapter 7 case or Chapter 11 case but not a Chapter 15 case) a statutory bankruptcy "estate" is created consisting of all assets and rights of the debtor as of the date of the filing: see 11 USC § 541. In Chapter 7 cases, a "trustee" is appointed over this estate. In Chapter 11 cases, while a trustee may be appointed, but in the first instance the authority and obligation to act as a trustee is vested in the debtor itself, which in such capacity is referred to as a "debtor in possession".

6 The most frequently cited provision of the US Bankruptcy Code is 11 USC § 105(a), which generally authorises relief "necessary or appropriate" to carry out statutory bankruptcy functions.

7 *In re Owens Corning*, 419 F3d 195, 211 (3d Cir 2005).

8 See 11 USC §§ 101(41), 109 (defining each individual, partnership and corporation as a separate legal "person" eligible to be a debtor in his / her /its own US bankruptcy case).

bankruptcy case of another group member to the same extent as any unaffiliated creditor or interested party.

Finally, in almost all cases in which it is granted, substantive consolidation only merges the assets and liabilities of affiliated debtors already subject to their own respective US bankruptcy cases. Nevertheless, although a minority of courts have concluded otherwise, most US courts to consider the issue have concluded they have the authority, in appropriate (and rare) circumstances, to substantively consolidate the bankruptcy estate of a debtor with the assets and liabilities of a related non-debtor.[9] The remedy has proved particularly useful in cases where the debtor used non-debtor entities as vehicles to perpetuate a Ponzi scheme or other fraudulent activity.[10]

1.1.2 Definition of a corporate group

There is no definition of a "corporate group" under the US Bankruptcy Code.[11] However, the Bankruptcy Code does use the defined terms "affiliate" and "insider" to regulate certain aspects of the bankruptcy process relevant to corporate groups.[12] An affiliate, which generally speaking is any entity with 20% or greater common ownership with the debtor entity in question, is always an insider. Other examples of insiders include the directors and officers of a corporation.

By using these defined terms, certain provisions of the US Bankruptcy Code and the US Bankruptcy Rules can be applied to facilitate certain relief and proscribe certain limitations on corporate group bankruptcies:

- rule 1015 of the US Bankruptcy Rules, which permits a bankruptcy court to order joint administration (i.e. procedural consolidation) of the US bankruptcy cases of two or more debtors who qualify as "affiliates" of one another; and

- section 1129(a)(10) of the US Bankruptcy Code, which requires the votes of "insiders" to be disregarded when determining whether an impaired class of creditors has voted to accept a proposed Chapter 11 plan.

Section 1129(a)(10) strikes a balance between two competing policy interests: on the one hand, corporate separateness should be respected in US bankruptcies and, on the other hand, that respect should not be a means for insider equity owners and

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[9] See for example *In re Mihranian,* 937 F.3d 1214, 1216–17 (9th Cir. 2019) ("Many courts, including this court, permit the substantive consolidation of both debtor and non-debtor entities"), and *In re Stewart,* 571 B.R. 460, 471 (Bankr. W.D. Okla. 2017) ("The Court agrees with the majority of authorities that under very limited circumstances it has the discretion, to be exercised sparingly, to substantively consolidate a debtor's estate with non-debtors"). But see, in contrast, *In re Concepts Am, Inc*, No 14 B 34232, 2018 WL 2085615, at 4–5, 8 (Bankr ND Ill 3 May 2018) (surveying prior decisions addressing the issue, acknowledging in the majority of those decisions that courts have held they have the discretion to order the substantive consolidation of a debtor with a non-debtor, but concluding "non-debtor substantive consolidation is not a remedy available to a court sitting in the Seventh Circuit").

[10] *In re Bonham*, 229 F3d 750, 769 (9th Cir 2000) (approving substantive consolidation of non-debtor entities into estate to allow bankruptcy trustee to pursue avoidance actions against investors who received fraudulent transfers in connection with debtor's Ponzi investment scheme); and see generally also *In re Woodbridge Group of Companies, LLC*, 592 B.R. 761 (Bankr. D. Del. 2018)

[11] As discussed below, the concept of corporate groups has been used to shape many areas of US federal legislation, including pension law, tax law and criminal law. However, as a general matter, the corporate group concept imbedded in those areas of the law has not had a material influence on the application of US bankruptcy law to corporate groups.

[12] 11 USC §§ 101(2) (defining affiliate), 101(31) (defining insider).

control persons to subvert the US Bankruptcy Code's distributional priority scheme, and benefit themselves to the detriment of non-insider creditors. Although section 1129(a)(10) on its face applies only to restructuring plans in Chapter 11 cases, its underlying policy was a key factor in the US Court of Appeals' refusal to enforce a Mexican restructuring plan in the Chapter 15 case of glass-maker Vitro, SAB de CV.[13] As a court examining that decision explained: "[t]he *Vitro* plan created only a single class of unsecured creditors and the necessary creditor votes to approve the plan were only achieved by counting the votes of insiders" – specifically the votes of Vitro's non-debtor subsidiaries which held large intercompany claims against their parent debtor.[14]

Because insider votes are not counted toward plan approval under section 1129(a)(10) of the US Bankruptcy Code, Vitro's Mexican plan "could not have been approved" if it were subject to the policy limitations imposed by that section on corporate group restructurings in Chapter 11.[15] As a result, the Court of Appeals concluded that the bankruptcy court did not abuse its discretion in refusing to grant comity and enforce the Mexican plan.[16]

1.1.3 Legislation relating to corporate groups

The author is not aware of any pending draft US legislation on this issue.

The concept of a "group" does appear in the recently enacted Small Business Reorganization Act of 2019, which came into effect on 19 February 2020 and added Subchapter V (11 U.S.C. §§ 1181-1195) to Chapter 11 of the US Bankruptcy Code. Chapter 11 had long been criticised as a poor one-size-fits-all restructuring regime that is too complex, time-consuming and costly for most individuals and small businesses to effectively reorganise.

Subchapter V is intended to mitigate the perceived challenges Chapter 11 posed for small business debtors by streamlining the reorganisation plan process and limiting the extent to which creditors can participate and vote down a plan relative to typical Chapter 11 cases. To prevent large debtors from taking advantage of the new law, Subchapter V was made available only to debtors with no more than US $3,024,725 in aggregate secured and unsecured non-contingent debt.[17] Moreover, to prevent large corporate groups from circumventing this requirement, new section 1182(1)(B)(i) of the US Bankruptcy Code also made Subchapter V unavailable to any debtor which itself had less than the statutory maximum but was a "member of a group of affiliated debtors that has aggregate noncontingent liquidated secured and unsecured debts in an amount greater than US $3,024,725 (excluding debt owed to 1 or more affiliates or insiders)." As a result, exceedingly few corporate groups (i.e. only those with less than

[13] *In re Vitro SAB de CV*, 701 F3d 1031, 1069 (5th Cir 2012).
[14] *In re Agrokor dd,* 591 BR 163, 173 (Bankr SDNY 2018).
[15] *Ibid.*
[16] *Idem*, 189.
[17] 11 USC §§ 1182(1)(A) (defining who can be a Subchapter V "debtor"). As originally enacted in 2019, the statutory maximum debt amount was US $2,725,625. That amount was increased to US $7,500,000 on March 27, 2020 for a period of two years, as part of the CARES Act legislation enacted to provide various relief in response to the COVID-19 pandemic. The increased debt limit under the CARES ACT ended on March 27, 2022. Although efforts in Congress are ongoing to reinstate the US $7.5 million debt limit, as of May 3, 2022 the debt limit, due to inflationary increases, was US $3,024,725.

US $3,024,725 of indebtedness in the aggregate) will be able to use Subchapter V to restructure in lieu of a full Chapter 11 case.[18]

1.2 Corporate group versus individual corporate benefit

1.2.1 The existence and relevance of "corporate group benefits"

As indicated above, the default rule under US bankruptcy law is to respect the separateness of corporate group entities by opening and maintaining a separate US bankruptcy case for each entity that, absent affirmative relief, will be administratively and substantively separate from the cases of other group members. Concepts akin to a "corporate group benefit" are explicit in some US statutory frameworks,[19] but not the US Bankruptcy Code or US Bankruptcy Rules.

Nevertheless, the concept does seem to have a practical influence in US bankruptcies. For example, oftentimes US bankruptcy courts presiding over corporate group cases will issue rulings about whether requested relief is in the best interests of the consolidated debtor group without making specific determinations with respect to the interests of each individual debtor's bankruptcy estate. By objecting, however, a creditor of one debtor in the corporate group can typically force the bankruptcy court to make such a determination before imposing relief that will permanently alter the assets and / or liabilities of that particular debtor. In turn, when determining the overall benefit or burden posed by requested relief on a particular debtor's estate, bankruptcy courts will sometimes account for an indirect benefit to or burden on the estate if relief directly impacting other debtors or the corporate group as a whole is granted. Absent substantive consolidation, whether and to what extent an indirect corporate group benefit (or burden) should be considered is not entirely clear from prior US bankruptcy case decisions. This has led to various attempts by parties to modern structured financing arrangements to supply more clarity by contract.

One context in which the concept of "corporate group benefit" frequently comes into play is US bankruptcy-related litigation concerning whether upstream guarantees made by operating subsidiaries can be avoided as constructively fraudulent transfers.[20] Financially distressed corporate groups often enter US bankruptcy having recently incurred significant financial indebtedness they can no longer service. Commonly, this group financing has been structured so only one or two corporate group members is the actual borrower, such as the group's parent or an intermediate holding company. As credit support, the subsidiaries in the corporate group, whose primary or only asset is stock ownership of other group members, will guarantee the

[18] Further discussion of Subchapter V is beyond the scope of this chapter.

[19] For example, the Employee Retirement Income Security Act (or "ERISA") is a federal law that governs employee pension plans in private industry and sets standards for how corporate group employers must operate pension and other benefit plans for employees of different group members. Similarly, the Internal Revenue Code's tax consolidation regime permits groups of commonly controlled corporations to file consolidated returns as a single taxpayer, thereby ignoring intercorporate distinctions and permitting the common parent to file on behalf of the members. In addition, the Racketeering Influenced and Corrupt Organizations Act (or "RICO") provides enhanced criminal and civil penalties for acts performed by or on behalf of a criminal enterprise, which can include a corporation or group of corporate entities.

[20] Specifically, regardless of intent, transactions can be avoided as "constructively fraudulent" if the debtor received less than reasonably equivalent value in connection with the transaction. Generally, if the debtor was insolvent at the time of the transaction, or rendered insolvent thereby, and did not receive reasonably equivalent value, the trustee of a US bankruptcy estate can "avoid" (i.e. unwind) the transaction: see 11 USC § 548(a)(1).

borrower's repayment obligations (i.e. upstream guarantees) and pledge substantially all of their assets as collateral securing the those guarantees.

One benefit of upstream guarantees and liens from the perspective of the lenders receiving them is the potential, in a bankruptcy scenario, to assert a claim for the entire amount of the indebtedness against the assets and estate of each corporate group member. Left unchecked, lenders could use this structure to dilute and marginalise the corporate group's other creditors who typically have unsecured claims against only one corporate group guarantor. US bankruptcy law does provide some checks, however, including the ability of a bankruptcy estate representative (typically a trustee or creditors' committee) to seek avoidance of the upstream guarantee obligations as constructively fraudulent.

If successful, such an avoidance action should limit the amount of the guarantee claim and lien that financing lenders can assert against the estate of any individual corporate group debtor to the amount of value that specific debtor actually received as a result of the group financing.[21] The parties will have divergent views about whether and to what extent subsidiary guarantors received value in the form of a corporate group benefit. The party attacking the transaction typically takes the position that the value received by each subsidiary guarantor must be limited to direct benefits it received, including the exact dollar amount of proceeds from the financing that was "downstreamed" by the parent borrower to fund the subsidiary guarantor's operations or satisfy its pre-existing liabilities.

By contrast, lenders hoping to shield their upstream guarantees from avoidance as much as possible typically argue each subsidiary guarantor, in addition to directly benefiting from downstreamed financing proceeds, also benefited indirectly from the overall benefit that the financing provided to the corporate group as a whole.

Whether a US bankruptcy court will recognise these indirect "corporate group benefits" is highly dependent upon the underlying circumstances in each case. US common law addressing the issue generally lacks clear and consistent guidelines for financial lenders to rely on in predicting whether their bargained for guarantees from the subsidiary members of a corporate group will be respected in a US bankruptcy.[22]

To minimise this uncertainty, so-called "savings clauses" have become a market feature of guarantee agreements in major US corporate financings. Generally speaking, a savings clause caps the size of the upstream guarantee each subsidiary provides in connection with a corporate group financing at the maximum amount of indebtedness that the subsidiary is able to incur without being rendered insolvent.

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[21] The US Bankruptcy Code provides transferees of constructive fraudulent transfers a defence to the extent they provided their debtor with value in good faith in exchange for the assets transferred or obligations incurred: see 11 USC §§ 548(c), 550(b). Thus, unless they lacked good faith, lenders' exposure to avoidance of their upstream guarantee with respect to any subsidiary guarantor should be limited to the difference between the amount guaranteed and the amount of value (if any) of the financing provided to the guarantor.

[22] Cf. *In re TOUSA, Inc*, 680 F3d 1298 (11th Cir 2012) (avoiding certain liens granted by corporate subsidiaries to lenders as security for loan to corporate parent, finding that the subsidiaries did not receive reasonably equivalent value for the liens) with *In re PSN USA, Inc*, No. 02-11913-BKC-AJC, 2011 WL 4031147, *6 (Bankr SD Fla 9 September 2011) (holding that a parent and subsidiary may share an "identity of interest" such that any benefit the parent receives may form the basis for a finding of reasonably equivalent value at the subsidiary level); see also *In re Sabine Oil & Gas Corp*, 547 BR 503, 547 (Bankr SDNY 2016) (holding that "the question of whether indirect benefits, whether received by entities as members of a single enterprise or otherwise, can constitute reasonably equivalent value for a guarantee is a question of fact").

Thus, where a subsidiary guarantor's upstream guarantee and supporting pledge of assets in the entire amount of a corporate group financing would render it insolvent and thereby subject the guarantee and pledge to avoidance as constructively fraudulent, an effective savings clause circumvents this result by limiting the amount of the financing parties' guarantee claim and lien against the subsidiary to only that portion of the financing that can be asserted without triggering avoidance exposure.[23] In practice, that amount is not determined unless and until the guarantee is called upon, and then is often hotly contested. Part of that dispute is whether and to what extent each subsidiary guarantor indirectly shares in a corporate group benefit from the financing.

1.2.2 Director liability

Unlike in a number of other jurisdictions, US business entities are not required to cease operations or commence US bankruptcy proceedings to restructure or wind up once they become insolvent. Moreover, directors and officers of these entities generally are not subject to liability for operating an insolvent business – that is, neither corporate law nor bankruptcy law in the US recognises a right to sue directors and officers for "trading while insolvent".[24] Thus, when a US corporate entity becomes insolvent, directors and officers have substantially the same liability exposure as they did when the entity was solvent. That exposure generally is limited to circumstances in which a director or officer breaches one of their fiduciary duties, such as the duty of care or the duty of loyalty. In short, directors and officers of US corporate entities are protected by a highly deferential legal regime in which their exposure to personal liability resulting from the insolvency of the business is the rare exception rather than the rule.

The US Bankruptcy Code and US Bankruptcy Rules respect and enforce applicable corporate law, which is the law of the state of the debtor entity's incorporation. Under state law, directors and officers owe fiduciary duties only to the entity for which they serve as director or officer. They owe no duties to any subsidiary or other affiliate of such an entity unless they also simultaneously serve as a director or officer of that subsidiary or affiliate.[25] Accordingly, corporate group benefit generally has no impact on directors' and officers' liability.

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[23] *In re Exide Tech, Inc*, 299 BR 732, 748 (Bankr D Del 2003) (noting that the savings clause "saves a portion of a transfer of collateral that might be avoided in its entirety if a Court deems the transfer to violate the fraudulent transfer or conveyance laws"). See generally also *In re Capmark*, 438 BR 471 (Bankr D Del 2010) (providing examples of form "savings clauses").

[24] Although there is some case law suggesting the existence of a state-law tort referred to as "deepening insolvency", US bankruptcy courts have generally refused to hold directors and officers liable for these types of claims without an independent showing that they breached their fiduciary duties to the debtor for which they serve. See *In re Verestar, Inc*, 343 BR 444, 476 (Bankr SDNY 2006) ("Unlike some foreign jurisdictions, where the law imposes liability on directors who continue to trade after the corporation becomes insolvent, under American law there is no duty to liquidate, untempered by the business judgment rule, upon insolvency") (citations omitted); see also *Fehribach v Ernst & Young LLP*, 493 F3d 905, 909 (7th Cir 2007) ("[T]he theory [of deepening insolvency] makes no sense when invoked to create a substantive duty of prompt liquidation that would punish corporate management for trying in the exercise of its business judgment to stave off a declaration of bankruptcy, even if there were no indication of fraud, breach of fiduciary duty, or other conventional wrongdoing").

[25] See *Trenwick Am Litig Trust v Ernst & Young, LLP*, 906 A2d 168, 191-92 (Del Ch 2006) ("Under settled principles of Delaware law, a parent corporation does not owe fiduciary duties to its wholly-owned subsidiaries or their creditors"). Unlike some non-US jurisdictions, US state law does not recognise a liability claim for fiduciary breach against a shareholder, director or officer of an affiliate of the debtor in a corporate group on the basis that he or she acted as a *de facto* or shadow director of the debtor itself. See e.g. *In re Nortel Networks, Inc*, 469 BR478, 499–505 (Bankr D Del

1.2.3 *"Early warning systems"*

US securities laws and regulations require all public and many private companies to produce periodic financial statements prepared by management and analysed by independent auditors in compliance with US generally accepted accounting principles (GAAP). Financial statements that comply with US GAAP are prepared under the assumption that the subject company will continue to operate as a going concern, and a company must disclose if adverse conditions or events cause its management or auditor substantial doubt whether it will be able to continue operations for the 12 months following the date of a statement. Further details of such "going concern" disclosures are beyond the scope of this update, but they could be characterised as a type of "early warning system" to shareholders and the investing public of a company's distressed financial condition and the increased likelihood of its insolvency.

However, US law does not impose any requirements on directors of individual legal entities to warn their corporate group parent of financial distress or to prepare restructuring or other contingency plans above and beyond what may be required of management to comply with its fiduciary duties to shareholders. Moreover, it is not clear additional early warning systems would be helpful. In practice, it is exceedingly rare for a US corporate group's slide into distress and bankruptcy to take its stakeholders or the marketplace by surprise.

1.2.4 *Pending or draft legislation*

The author is not aware of any pending or draft legislation concerning this issue.

1.3 Universalism versus territorial principle

1.3.1 *Application of the modified universalism rules*

Chapter 15 of the US Bankruptcy Code is based on and substantially incorporates (with relatively minor deviations) the United Nations Commission on International Trade Law Model Law on Cross-Border Insolvency (Model Law) and is generally recognised to embrace the principles of "modified universalism".[26] In particular,

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2012) (analysing and ultimately dismissing breach claims against a debtor for allegedly acting as *de facto* or shadow directors of its sister company under English, Irish and French – but not US – law). However, the same conduct that would support such a claim under foreign law may be sufficient to support cognisable claims under US state law for aiding and abetting a breach of fiduciary duty by the debtor's actual director: ibid *Nortel* 510–11 (ruling same basic allegations that were pled in support of *de facto* or shadow director claims under English, Irish and French law were sufficient to support claims under Delaware and Texas law for aiding and abetting breaches of fiduciary duty committed by directors of debtor's sister company). Beyond aiding and abetting liability, and only in the most extreme circumstances where influence or control is pervasive, liability claims against a shareholder, director or officer of an affiliate of the debtor in a corporate group may succeed under "piercing the corporate veil" or "fundamental fairness" jurisprudence. See HvJ Miguens, "Liability of a Parent Corporation for the Obligations of an Insolvent Subsidiary Under American Case Law and Argentine Law" (2002) *10 American Bankruptcy Institute Law Review* 217, 220-228 (discussing the small number of American case decisions in which liability was imposed and observing "[i]n contrast with the foregoing decisions imposing liability on the parent of the insolvent subsidiary, trustees in bankruptcy and creditors of an insolvent subsidiary (or controlled corporation) have been unsuccessful in their efforts to impose liability upon the parent corporation (or controlling shareholder) in the overwhelming majority of cases").

[26] See *In re ABC Learning Centres Ltd*, 728 F3d 301, 306 (3d Cir 2013) ("Chapter 15 embraces the universalism approach"); J L Westbrook, "Chapter 15 At Last" (2005) 79 *American Bankruptcy Institute Law Review* 713, 715.

Chapter 15 adopts procedures in the Model Law for both inbound and outbound ancillary proceedings:

- *Inbound*

  Sections 1504 and 1515 of the US Bankruptcy Code enable the representative of a foreign (non-US) insolvency proceeding to open a Chapter 15 case (i.e. a US ancillary proceeding) by filing a petition for recognition of the foreign proceeding.[27] Assuming the petition is granted, the foreign representative may access a broad range of relief intended to facilitate outcomes that embody modified universalism. For example, section 1521 of the US Bankruptcy Code, based on article 21 of the Model Law, authorises the foreign representative to request a suite of statutory remedies, including the ability to protect, collect and repatriate for distribution in the foreign proceeding those assets of the foreign debtor located within the US (a universalist outcome).[28] However, the US bankruptcy court may scrutinise the request and deny it unless "the interests of the creditors and other interested entities, including the debtor, are sufficiently protected"[29] – a test that has been used on occasion to deny universalist outcomes;[30] and

- *Outbound*

  Section 1505 of the US Bankruptcy Code, which largely incorporates article 5 of the Model Law, authorises the US bankruptcy court to enable certain representatives of a US bankruptcy case to open ancillary proceedings and act on behalf of the plenary bankruptcy estate in foreign jurisdictions.[31] Subject to limitations imposed by the US court (if any), the appointed representative may act in any way permitted by applicable foreign law.[32]

1.3.2 Bilateral and / or multilateral treaties in force

The primary regulation of ancillary proceedings in the US is the statutory scheme of Chapter 15 of the US Bankruptcy Code. The US is a common law legal system, and, therefore, case law is an important secondary source of authority for the application of

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[27] 11 USC §§ 1504 and 1515.
[28] 11 USC § 1521.
[29] 11 USC § 1522.
[30] See e.g. *Jaffe v Samsung Elec Co, Ltd*, 737 F3d 14 (4th Cir 2013) (denying request of foreign representative to enforce German insolvency court's order granting relief expressly prohibited in US plenary bankruptcy cases by US bankruptcy statute, holding that US bankruptcy courts "may only grant discretionary relief under [11 USC] § 1521 if it determines that 'the interests of the creditors and other interested entities, including the debtor, are sufficiently protected'") (quoting 11 USC § 1522(a)); see also *In re Vitro SAB de CV*, 701 F3d at 1060 (finding, in *dicta*, that even if §1521 of the US Bankruptcy Code authorised enforcement of non-consensual third-party releases contained in the Mexican reorganisation plan, § 1522 would prohibit such enforcement).
[31] See 11 USC § 1505. Unlike art 5 of the Model Law, § 1505 of the US Bankruptcy Code requires the trustee or entity acting on behalf of the US bankruptcy estate to obtain US court approval prior to acting abroad.
[32] US bankruptcy courts routinely permit a debtor-in-possession to act as the foreign representative of the estate in a foreign proceeding when necessary to protect the value of the debtor's estate and assets. See for example *In re Purdue Pharma L.P.*, No. 19-23649 (RDD) (Bankr. S.D.N.Y. Sept. 18, 2019) [Docket No. 70]; *In re TK Holdings Inc., et al*. [U.S. subsidiaries of Japanese airbag manufacturer Takata], No. 17-11375 (BLS) (Bankr. D. Del. June 27, 2017) [Docket No. 114]; *In re Cal Dive International, Inc*, No 15-10458 (CSS) (Bankr D Del 6 March 2015) [Docket No 61]; *In re Allied Sys Holdings, Inc*, No 12-11564 (CSS) (Bankr D Del 12 June 2012) [Docket No 97]; *In re TerreStar Networks Inc*, Case No 10-15446 (SHL) (Bankr SDNY 20 October 2010) [Docket No 30].

modified universalism in Chapter 15 cases. The US is not currently party to any bilateral or multilateral treaties with other countries concerning cross-border insolvency proceedings.

1.3.3 Pending legislation

The author is not aware of any upcoming legislative changes concerning this issue.

1.4 Competent court and applicable law

US federal district courts have exclusive and original subject matter jurisdiction over cases arising under the US Bankruptcy Code, including both plenary and ancillary (i.e. cross-border cases).[33] In practice, the district courts refer both types of cases and certain related disputes to specialised bankruptcy courts within each federal district.[34]

Ancillary Chapter 15 cases are commenced by the filing of a petition seeking recognition in the US of an insolvency proceeding pending in a non-US jurisdiction (i.e. a foreign proceeding). Only a duly-authorised representative of the foreign proceeding in question (i.e. its foreign representative) is permitted to file a petition commencing a Chapter 15 case. Thus, neither the debtor subject to the foreign proceeding nor any of its creditors have direct authority to commence a Chapter 15 case. That said, it is not uncommon for corporate group debtors and their creditors to agree as a condition to implementation of a foreign restructuring plan that a Chapter 15 case must be opened and the appointed foreign representatives must obtain an order from the US bankruptcy court enforcing the foreign plan within the US.

By contrast, plenary Chapter 7 or 11 bankruptcy cases for members of a corporate group may be initiated voluntarily by each debtor's management or involuntarily (i.e. without support of the debtor entity in question) by three or more creditors holding unsecured claims of at least US $18,600 in the aggregate that are not contingent as to liability or subject to a bona fide dispute as to either liability or amount.[35] Unlike when a debtor files a voluntary petition, which causes a bankruptcy case to be opened automatically, a bankruptcy case commenced by creditors will not be opened until their involuntary petition is granted by the US bankruptcy court upon a determination that either: (1) the debtor is not generally paying its debts as they become due; or (2) a trustee or receiver was appointed over some portion of the debtor's property within 120 days before the petition.[36]

By statute, the proper venue for a Chapter 15 case isthe bankruptcy court in the US District: (1) in which the debtor has its principal place of business or principal assets in the United States; (2) if the debtor does not have a place of business or assets in the United States, in which there is pending against the debtor an action or proceeding in a Federal or State court; or (3) in a case other than those specified in paragraphs (1) and (2), in which venue will be consistent with the interests of justice and the convenience of the parties, having regard to the relief sought by the foreign representative.[37]

[33] 28 USC § 1334(a).
[34] 28 USC § 157(a).
[35] 11 USC § 303(b).
[36] 11 USC § 303(h).
[37] 28 USC § 1410.

Thus, in the first instance the competent court to preside over a Chapter 15 case will be dictated by the location of a foreign debtor's business and assets in the US. Notwithstanding paragraphs (2) and (3) above, which appear to provide for proper venue of a Chapter 15 case involving a debtor with no business or assets in the US, the US Court of Appeals for the Second Circuit has ruled, in a decision binding on all New York bankruptcy courts and followed as persuasive authority by courts in other federal circuits, a foreign debtor is not eligible to be subject to a Chapter 15 case unless it has a domicile, place of business or property in the US.[38] To comply with this requirement in circumstances where the foreign debtor has no existing business or assets in the US, prior to filing a petition foreign representatives often open a retainer account with their Chapter 15 counsel at a bank located in the district they wish to file and place debtor funds in that account.[39] Thus, in most Chapter 15 cases, including corporate group cases, the petitioning foreign representative effectively can choose which US district can preside over its Chapter 15 case.

Different rules provide similar flexibility in determining where a corporate group restructuring will proceed in a plenary Chapter 11 case. A plenary case may be opened in any US district in which the subject debtor entity has had its principal place of business or principal assets in the US for the 180 days prior to the commencement of such case.[40] In the specific context of corporate group restructurings, once a Chapter 11 case is properly opened by one member of the debtor group in a particular US district, a separate case may thereafter be opened in that same US district for any "affiliate"[41] of the first debtor within the corporate group, regardless of whether the affiliate has a place of business or assets in that district.[42] This statutory mechanism allows many large distressed enterprises with headquarters and operations throughout the US or internationally to open Chapter 11 bankruptcy cases for their entire corporate group before a single US bankruptcy court. In practice, many corporate group debtors use this mechanism to open bankruptcy cases in select jurisdictions, such as Delaware or the Southern District of New York, despite having little or no connection to the jurisdiction other than having incorporated one or more group members there. Some US lawmakers and practitioners have criticised this practice as easy to manipulate, often resulting in Chapter 11 cases for a corporate group proceeding in a bankruptcy court far away from the employees, non-financial creditors (e.g. vendors and landlords), and surrounding communities most impacted by its financial distress and efforts to reorganise. To date, however, all attempts to change the law and force corporate groups to go through Chapter 11 in the jurisdiction where their headquarters or primary assets and operations are located have failed.

This practice in Chapter 11 cases creates interesting contrasts with Chapter 15 cases involving corporate groups, in which the location of any group member's headquarters, primary assets or majority creditors outside the jurisdiction of the

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[38] *Drawbridge Special Opportunities Fund LP v Barnet (In re Barnet)*, 737 F.3d 238 (2d Cir. 2013) (applying "debtor" requirements for plenary bankruptcy cases in 11 USC § 109(a) to ancillary Chapter 15 cases).

[39] See for example *In re Berau Capital Resources Ptd Ltd*, 540 B.R. 80, 81-82 (Bankr. S.D.N.Y. 2015) (section 109(a) satisfied by attorney retainer account, and also by debtor contract rights located in New York as a result of debtor being obligor on over $450 million of U.S. dollar denominated debt over which New York law expressly governs in debt indenture which also included New York choice of forum clause).

[40] 28 USC § 1408(1).

[41] For the US Bankruptcy Code's definition of "affiliate," see the discussion above. See also 11 USC § 101(2).

[42] 28 USC § 1408(2).

foreign proceeding for which Chapter 15 recognition is sought can limit the relief available from the US bankruptcy court. A Chapter 15 case must seek recognition of the subject foreign proceedings as either a "foreign main proceeding" – i.e. a proceeding pending in the country where the debtor has its centre of main interests (COMI) – or a "foreign non-main proceeding" – i.e. a proceeding in a country where the debtor has an establishment but not its COMI.[43]

In the case of corporate groups, a determination of COMI is separately made for each foreign debtor in the group regardless where the group operates as a whole or the sequence in which Chapter 15 petitions for each group member were filed.

Moreover, although the foreign jurisdiction where each debtor's registered office is located is statutorily presumed to be its COMI, that presumption can be rebutted by consideration of the very factors arguably ignored in the Chapter 11 context, including the location of the debtor's headquarters, primary assets, employees and other creditors.

As a result, achieving recognition and enforcement in the US of a foreign proceeding and plan of reorganisation for a corporate debtor group involving numerous affiliates registered and doing business in various international jurisdictions can be much more challenging than confirming a Chapter 11 plan under similar circumstances. An example of this played out recently in the Constellation Group restructuring decisions in which the corporate group ultimately implemented a Brazilian restructuring plan that was recognised and enforced in the US through Chapter 15 cases, but only after several false starts and re-filings on behalf of certain foreign debtor affiliates which were registered and found to have their COMI outside of Brazil.[44]

1.4.1 *Applicable law that falls outside of* **the lex fori concursus** *and related issues*

US bankruptcy law purports to apply globally in plenary cases – to all creditors and property of a bankruptcy estate, wherever located.[45] The courts have recognised that the "bankruptcy court's *in rem* jurisdiction is broad and reaches property wherever located", and that Congress "explicitly gave bankruptcy courts global reach over the debtor's property".[46] Pursuant to its broad jurisdiction over the bankruptcy estate, a US bankruptcy court may prohibit creditors from seeking remedies or adjudication of their claims in foreign jurisdictions when doing so would conflict with the bankruptcy

[43] See 11 USC §§ 1517 and 1502(4)–(5); see also 11 USC § 1502(2) (defining "establishment" as "any place of operations where the debtor carries out a non-transitory economic activity"). US courts have held that a debtor's COMI should be determined as of the time the Chapter 15 petition is filed, rather than as of time the foreign proceeding is initiated, but "[t]o 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": see *In re Fairfield Sentry Ltd*., 714 F.3d 127, 133 (2d Cir. 2013).

[44] *In re Serviços De Petróleo Constellation S.A., et al*., 600 B.R. 237 (Bankr. S.D.N.Y. 2019); *In re Serviços De Petróleo Constellation S.A., et al*., 613 B.R. 497 (Bankr. S.D.N.Y. 2020); and *In re Olinda Star Ltd*., 614 B.R. 28 (Bankr. S.D.N.Y. 2020).

[45] See 28 USC § 1334(e) (providing US courts with jurisdiction over "all the property, wherever located, of the debtor" in a Chapter 11 bankruptcy case); 11 USC § 541(a)(1) (property of the bankruptcy estate includes "all legal or equitable interests of the debtor in property as of the commencement of the case … wherever located and by whomever held").

[46] *In re Lehman Bros Holdings, Inc*, 535 B.R. 608, 628 (Bankr SDNY 2015); see also *Hong Kong & Shanghai Banking Corp, Ltd v Simon (In re Simon)*, 153 F3d 991, 996 (9th Cir 1998) ("Congress intended extraterritorial application of the Bankruptcy Code as it applies to property of the estate").

court's adjudication of the issues before it and may punish creditors violating such orders.[47]

Notwithstanding their broad jurisdiction, US bankruptcy courts may decline to hear disputes that are subject to the jurisdiction of foreign bankruptcy proceedings on the grounds of comity.[48]

Although US bankruptcy courts do have subject matter jurisdiction to resolve disputes concerning any of a debtor's property located in foreign jurisdictions, the practical impact of their orders is limited when property is located outside of US borders and under the custody and control of individuals or businesses that are (and intend to remain) beyond the reach of US law enforcement.

1.4.2 Harmonisation of substantive restructuring and insolvency laws

With respect to cross-border cases inbound to the US, the harmonisation of insolvency laws would arguably be beneficial. From the perspective of a US creditor, savvy corporate groups may be able to strategically leverage the general inclination of US courts to respect non-US insolvency proceedings to sidestep creditor protections in US bankruptcy law that are reduced or absent altogether in the insolvency laws of other jurisdictions by steering a corporate group restructuring to those other jurisdictions. Therefore, the argument goes, greater consistency between the substantive restructuring and insolvency laws of the US and those other jurisdictions would result in fewer opportunities to disadvantage US creditors.

For example, at the time of the *Vitro* case discussed above, the use of intercompany claims to mass voting majorities required for court approval of corporate group restructuring plans was not precluded under Mexican insolvency law.[49] After that case concluded, amendments to Mexican insolvency law aimed at prohibiting corporate group restructurings in this manner ostensibly brought it more in line with the US

[47] See *In re MF Global Holdings Ltd*, Case No. 11-15059 (MG) 2017 WL 119140, at *8 & n10 (Bankr SDNY 12 January 2017) (holding that Bermuda-based insurers violated the bankruptcy court's temporary restraining order when the insurers obtained an order from a Bermuda court enjoining US-based plaintiffs from pursuing adjudication of their claim in the Chapter 11 case, and noting that the court would consider holding the insurers in contempt, "with possible sanctions including striking their pleadings and entering a default"); *Lyondell Chem Co v CenterPoint Energy Gas Servs Inc* (*In re Lyondell Chem Co*), 402 BR 571, 575 (Bankr SDNY 2009) (enjoining, for a period of 60 days, the debtor's creditors from pursuing remedies, including the commencement of involuntary insolvency proceedings in foreign countries, against the debtor's non-debtor parent); and see also Order Confirming First Amended Joint Plan of Reorganization, *In re Scrub Island Development Group Ltd*, No 13-15285-MGW, 2015 WL 1132792 (Bankr MD Fla) at *17 (ordering the debtors' lender to dismiss, with prejudice, a receivership proceeding commenced by the lender with respect to the debtors' assets located in the British Virgin Islands).

[48] See *JP Morgan Chase Bank v Altos Hornos de Mexico, SA de CV*, 412 F.3d 418, 424 (2d Cir 2005) (noting that international comity involves "the discretion of a national court to decline to exercise jurisdiction over a case before it when that case is pending in a foreign court with proper jurisdiction" and observing that "US courts should ordinarily decline to adjudicate creditor claims that are the subject of a foreign bankruptcy proceeding" because in those cases "deference to the foreign court is appropriate so long as the foreign proceedings are procedurally fair and … do not contravene the laws or public policy of the [US]").

[49] At trial before the US Chapter 15 court, Vitro introduced uncontroverted evidence that numerous prior Mexican corporate group restructurings had been effectuated in this manner and the court, after noting objecting creditors were active participants in the Mexican main proceedings, refused to entertain their arguments that Mexican law had been violated: see *In re Vitro, SAB de CV*, 473 B.R. 117, 130–131 (Bankr ND Tex), *aff'd sub nom* See *In re Vitro SAB de CV*, 701 F.3d 1031 (5th Cir 2012).

Bankruptcy Code.[50] It is unclear whether this amendment has prevented significant subsequent US litigation on this issue concerning Mexican corporate group restructurings.[51]

With respect to cross-border cases outbound from the US, harmonisation may be less impactful generally. US bankruptcy courts employ an expansive definition of personal jurisdiction including over many individuals and businesses located, domiciled or incorporated outside the US so long as they have certain "minimum contacts" with the US.[52] Thus, for example, individuals wishing to travel to the US or corporate groups wishing to borrow money or conduct business in the US are likely to comply with a US bankruptcy court order even if the same order could not be obtained under substantive law in their home jurisdiction. As a result, in most cases US restructurings can be enforced as a practical matter even without assistance from non-US courts.[53]

That said, differences between the powers to avoid and clawback pre-bankruptcy transfers under US law (which are very broad) and under the laws of other jurisdictions have been the source of much US litigation in recent years, particularly in Ponzi scheme bankruptcies that spread outside the US. Until recently, multiple lower court decisions arising out of the *Madoff* US bankruptcy case held that payments received by transferees that had invested with Madoff through off-shore feeder funds could not be clawed back under US law where those funds themselves were subject to insolvency proceedings in their jurisdictions of incorporation (such as the British Virgin Islands). The reasoning was that US courts, as a matter of international comity, should abstain from seeking to clawback the same payments that foreign liquidators may be able to clawback for the benefit of creditors in the non-US proceedings of the feeder funds. Arguably, the effect of those decisions was to insulate many investor payments from any clawback exposure at all because of the limited clawback powers available under governing law in the feeder fund offshore proceedings. Notwithstanding, those decisions were recently reversed on appeal[54] and, unless and until avoidance and clawback laws are harmonised, litigation in cross-border cases between those hoping to apply US law and those hoping to avoid its broad application is likely to continue.

1.4.3 Relevant treaties or case law

As indicated above, Chapter 15 of the US Bankruptcy Code permits foreign representatives to seek the assistance of US bankruptcy courts to recover property of the foreign debtor located in the US and to enforce judgments issued in the foreign proceeding. Chapter 15 encourages courts to follow "principles of comity and cooperation with foreign courts in deciding whether to grant" enforcement of foreign court orders.[55] After recognition is granted under Chapter 15, the foreign

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[50] See January 2014 amendments to Article 157 of *Ley Concursos de Mercantiles*.

[51] The *Vitro* decision itself, which predated these amendments, likely had the same impact.

[52] See Fed R Bankr Pro 7004(f); Fed R Civ P 4(k); *In re Uni-Marts, LLC*, 405 B.R. 113, 121-22 (Bankr D Del 2009); *In re Bernard L Madoff Investment Securities LLC*, 418 BR 75 (Bankr SDNY 2009) (finding that Swiss account holders had sufficient minimum contacts with the US to support the bankruptcy court's personal jurisdiction over them where they conducted financial transactions to and from New York bank accounts and sent correspondence to the US concerning transfers from New York accounts).

[53] See *MF Global Holdings Ltd*, 2017 WL 119140, at *8 (observing that, even if the US bankruptcy court's judgment against Bermuda-based insurers was not recognised by a Bermudian court, "the Bermuda Insurers write insurance policies for and collect premiums from companies in New York and the United States, so the Plaintiffs may well have recourse to recover on any judgment obtained in the United States, if that eventuality comes to pass").

[54] These decisions were recently reversed. See *In re Picard, Tr for Liquidation of Bernard L Madoff Inv Sec LLC*, 917 F3d 85, 103–105 (2d Cir 2019).

[55] *In re Metcalfe & Mansfield Alternative Investments*, 421 B.R. 685, 696 (Bankr SDNY 2010); see also 11

representative may seek "additional assistance" from the US court to enforce the results of the foreign insolvency proceeding within the US.[56]

In determining whether to offer such assistance, the US court must consider, "consistent with the principles of comity", whether enforcing the order would reasonably assure just treatment of all claimants, protection of US claimants from prejudice and inconvenience in the processing of claims in the foreign proceeding, and prevention of fraudulent dispositions of the debtor's property.[57] In practice, courts tend to focus on whether the foreign proceeding was procedurally fair.

Although US bankruptcy courts have discretion to refuse to enforce a foreign order because it grants substantive relief unavailable under US law,[58] to date they have exercised that discretion sparingly and typically enforce such orders.[59]

1.4.4 *Upcoming new legislation*

The author is not aware of any upcoming legislative changes concerning this issue.

2. Substantive consolidated restructuring proceedings versus synthetic group restructuring

US bankruptcy courts will adjudicate the Chapter 11 case of a foreign-domiciled entity when it is an affiliate of a US entity, so long as it has a minimal quantity of property in the US. The courts have defined the "property" requirement broadly and hold that only a minimal amount of property in the US is needed to qualify as a debtor.[60] It is not uncommon, therefore, for multinational corporate groups to open Chapter 11 cases not only for the group's US affiliates, but for the group's non-US affiliates as well.

If a foreign-domiciled entity's bankruptcy case is being administered by a US bankruptcy court under Chapter 11, there is no statutory or common law authority that would permit a US court to apply the law of a foreign jurisdiction to that case so as to

USC § 1509(b)(3) (where a court grants recognition of a foreign proceeding, it "shall grant comity or cooperation to the foreign representative").

56 See 11 USC § 1507(a).

57 11 USC §1507(b).

58 11 U.S.C. §§ 1507(b) (providing that when granting "additional relief," the court should consider, among other things, whether the relief will reasonably assure distribution of the debtor's property "substantially in accordance with the order prescribed by [the Bankruptcy Code]"); 1521 (specifying various forms of relief that may be granted upon recognition of a foreign proceeding, but only "where necessary to effect the purpose of [the Bankruptcy Code]" and subject to various restrictions set forth in subsections (b)-(f))

59 *In re Metcalfe & Mansfield*, 421 BR at 696-898 (granting requested enforcement of a Canadian reorganisation plan that included third-party non-debtor releases, notwithstanding that such releases would likely not be authorised under US law, where the releases treated all claimants in the Canadian proceeding similarly, the Canadian procedures were "consistent with standards of US due process" and thus satisfied "our fundamental standards of fairness", and there was no challenge to enforcement in the US); *In re Sino-Forest Corp*, 501 BR 655, 665 (Bankr SDNY 2013) (enforcing a non-debtor release and injunction issued by a Canadian bankruptcy court, following the court's reasoning in *Metcalfe*); see also *In re Rede Energia SA*, 515 BR 69, 100 (Bankr SDNY 2014) (noting that the creditors opposed to the enforcement of a Brazilian reorganisation plan that substantively consolidated a corporate group had exercised their due process rights in Brazil to both object to the plan and appeal the decision approving the plan, and holding that the plan should be enforced in the US pursuant to §§1521 and 1507 of the US Bankruptcy Code, even where the Brazilian legal standard for substantive consolidation diverged from the US standard).

60 See *In re McTague*, 198 BR 428, 431-32 (Bankr WDNY 1996) (a US bank account containing $194 was sufficient "property" to make the account holder eligible to be a debtor under §109(a)).

replicate the results that would be achieved in a proceeding in that jurisdiction. Thus, a synthetic consolidated group restructuring is unavailable in the US. However, a foreign-domiciled debtor that has opened a case under Chapter 11 may still seek the appointment of a foreign representative under section 1505 of the US Bankruptcy Code to initiate an outbound ancillary proceeding.

3. Duty to initiate insolvency process

As noted above, there is no obligation for directors of a US legal entity to open a bankruptcy case for that entity because a parent or affiliate within the same corporate group has become insolvent or opened their own insolvency proceedings outside the US.[61] Further, there is no requirement that a US entity or corporate group must be restructured under the laws of the US.

Thus, there is no law in the US that would expressly prevent US courts from recognising a synthetic group restructuring in a foreign jurisdiction. In fact, in at least one instance, a US bankruptcy court has granted Chapter 15 recognition of a foreign main proceeding involving a corporate group that included one US incorporated debtor.[62]

However, the fact that US law does not prohibit US entities from being reorganised together with their corporate group in another jurisdiction does not ensure the results of the group's foreign proceedings will be recognised and enforced in the US. The US Bankruptcy Code affords US creditors several protections in these circumstances. For example, if US-based creditors believe they would do better in a US-based restructuring than they would in a foreign restructuring, they may seek to place the US entities within a corporate group (alone or together with some or all of the foreign entities in the group) into involuntary bankruptcy cases under Chapter 7 or Chapter 11 of the US Bankruptcy Code.[63] To the same end, at the urging of US creditors or of its own volition, a foreign-based corporate group with US affiliates may open Chapter 11 cases in the US in an attempt to avoid some aspect of foreign insolvency law perceived to be detrimental relative to the protection and relief available under the US bankruptcy code. In either scenario, the likely result is that either US and non-US proceedings open and progress in parallel,[64] or a struggle for main proceeding status ensues.

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[61] Nor is it mandatory for a US entity to be placed into bankruptcy if it is rendered insolvent or likely insolvent as a result of the financial condition or opening of insolvency proceedings for its parent or affiliates. Oftentimes, however, bankruptcy may be the best (if not only) means to protect and preserve the US entity's assets and business operations in those instances. Fiduciaries of a US entity whose foreign parent or corporate group affiliates have been placed into insolvency proceedings should consider whether opening a US bankruptcy case is in the best interests of the entity's stakeholders.

[62] See Order Recognising Foreign Main Proceeding and Granting Additional Relief, *In re Karhoo Inc*, No 16-13545 (Bankr SDNY 1 February 2017) [Docket No 31] (recognising UK administrations of Delaware parent corporation and several UK subsidiaries as foreign main proceedings).

[63] A bankruptcy case may be initiated involuntarily (i.e. without support of the debtor entity in question) by three or more creditors holding unsecured claims of at least US $18,600 in the aggregate that are not contingent as to liability or subject to *bona fide* dispute as to either liability or amount: 11 USC § 303(b)). Unlike when a debtor files a voluntary petition, which causes a bankruptcy case to be opened automatically, a bankruptcy case commenced by creditors will not be opened until their involuntary petition is granted by the US bankruptcy court upon a determination that either: (1) the debtor is not generally paying its debts as they become due; or (2) a trustee or receiver was appointed over some portion of the debtor's property within 120 days before the petition. 11 USC § 303(h).

[64] In a recent example, creditors successfully initiated an involuntary Chapter 7 case in New York during the 60-day interim period between the commencement of a provisional liquidation proceeding for

In cases of struggle, the presiding US bankruptcy court is typically urged by foreign creditors and / or insolvency practitioners (IPs) to dismiss or abstain from adjudicating the Chapter 11 case so that the foreign insolvency proceedings can be initiated and continue unabated.[65]

This struggle recently played out in the *Exelco* case, where a corporate debtor group predominantly centred in Belgium, but with two US subsidiaries, filed for Chapter 11 in Delaware in an attempt to block liquidation proceedings against the group that had been brought by two creditors in Belgium.[66] At the outset of the Chapter 11 cases, the Delaware bankruptcy court issued orders intended to halt the Belgian proceedings by restraining the two Belgian creditors. Nevertheless, the Belgian court moved forward by ordering the appointment of Belgian liquidators and directing them to seek Chapter 15 recognition of the Belgian liquidation from the Delaware bankruptcy court. Although the Delaware court found it had the authority to reorganise the entire corporate group (in part because of the group's Delaware affiliates), the court granted the Belgian creditors' motion to dismiss the Chapter 11 cases in deference to the Belgian liquidation and granted the Belgian liquidators' petition for Chapter 15 recognition of the liquidation as a "foreign main proceeding".[67] In reaching this conclusion, the Delaware court applied a seven-factor abstention test that includes consideration of whether the non-US forum protects the interest of creditors and the economical and efficient administration of the debtors' affairs, among other factors.[68]

In explaining its decision, the Delaware court noted that, prior to commencing Chapter 11, the corporate group had voluntarily opened (then subsequently dismissed) its own Belgian proceeding and, therefore, could not credibly claim any prejudice or unfairness in being subjected to further Belgian proceedings at the hands of its Belgian creditors.[69] The Delaware court also interpreted the actions by the Belgian court as a clear indication that it would not enforce the effects of a Chapter 11

the same debtor before the Grand Court of the Cayman Islands and the conversion of those proceedings to a court-supervised official Cayman liquidation: *Lamonica v CEVA Group plc (in re CIL Ltd)*, 582 BR 46, 66 (Bankr SDNY 2018). Following his appointment in the US bankruptcy case, the Chapter 7 trustee entered into an international protocol with the joint official liquidators in the Cayman proceeding by which the IPs agreed to allow certain avoidance actions and other recovery claims to be pursued in the Chapter 7 case, ostensibly because they agreed US law offered greater chances for successful recovery on such claims than Cayman law: ibid. Notwithstanding the protocol agreement, however, the US bankruptcy court subsequently dismissed certain of those claims brought by the Chapter 7 trustee under US law, holding that a choice of law analysis indicated the claims should be brought (if at all) under Cayman law: see *idem*, 99–103.

65 For example, in *In re Northshore Mainland Services, Inc*, 537 BR 192 (Bankr D Del 2015), a corporate group of 14 Bahamian entities with one Delaware affiliate in the midst of constructing a hotel and casino resort property in the Bahamas voluntarily filed Chapter 11 cases in Delaware, hoping to use the cases to keep their secured lender at bay while obtaining additional financing to complete construction. The secured lender, which was affiliated with the project's general contractor, whom the debtors blamed for construction being significantly delayed and over-budget, moved to dismiss the cases in favour of insolvency proceedings in the Bahamas. The debtors objected to dismissal, including on the basis that Bahamian insolvency law lacked a restructuring regime and therefore dismissal of the Chapter 11 cases would lead directly to liquidation proceedings in the Bahamas for the benefit of the secured lender. Ultimately, the Delaware bankruptcy court dismissed the Chapter 11 cases of the 14 Bahamian entities, after which ownership and control of the project was promptly wrested from the debtors' equity sponsor through Bahamian liquidation and receivership proceedings.

66 See *In Re Elexco NV*, 17-BK-12030 (Bankr D Del 13 December 2017).

67 *Idem* [Docket Nos 84, 98-2].

68 *Idem* [Docket No. 98-2], 227.

69 *Idem* [Docket No. 98-2], 222.

restructuring in Belgium where the corporate group's assets and business were almost exclusively located.[70]

In summary, assuming that a corporate group had opened a main proceeding in a foreign jurisdiction, and that the creditors of the group's US affiliates would be no worse off (and no better off) in the absence of a bankruptcy filing for the US affiliates, there would be a sufficient legal basis not to open US bankruptcy proceedings. Of course, each situation is different, and directors of US-based entities should seek advice from appropriate professionals, particularly where opening US proceedings could potentially result in a better outcome for the US entities' creditors. Ultimately, as long as the directors have fulfilled their duties of care and loyalty in good faith, under the "business judgment rule", US courts will presume that the directors' decision regarding whether to open US bankruptcy proceedings was valid and proper, so long as a rational business purpose for the decision has been articulated.

4. Legal certainty and predictability

4.1 Legal certainty and predictability to local creditors

In the event of a corporate group's restructuring in a non-US jurisdiction, the best means to ensure legal certainty and predictability in the US would be to file Chapter 15 proceedings, if available. Such a filing would protect the corporate group and its foreign creditors from actions that could be taken by local US creditors, such as execution against US assets or the commencement of litigation aimed at disrupting the foreign restructuring efforts.[71]

4.2 Communications with local courts and creditors

To satisfy due process concerns, US debtors must provide proper notice of the bankruptcy to both known and unknown creditors. If a creditor is known, the debtor must provide actual notice of the bankruptcy proceedings. For unknown creditors, the debtor can provide constructive notice by publishing information about the bankruptcy, typically through notices in newspapers. When notice is provided by publication, the court determines the form and manner of such publication, including which newspapers or other medium to be used and the number of publications.[72] To satisfy due process concerns, the debtor must use methods of publication notice that are reasonably calculated to inform unknown creditors. Debtors can generally satisfy this requirement by publishing in a national newspaper and local newspapers in the regions where the debtor conducts business.[73]

4.3 Guarantees by the IP in office

There is no requirement under US law for an IP to provide any guarantees during the administration of a bankruptcy case. Nevertheless, to the extent an IP seeks Chapter 15 recognition of a non-US proceeding to restructure the assets or affairs of a corporate group with assets or affairs in the US, US creditors concerned about their treatment in the non-US proceeding do have a number of other protections under the US Bankruptcy Code. For example, in a Chapter 15 case, US bankruptcy courts will not turn over assets located in the US to the foreign representative for repatriation and

[70] *Idem* [Docket No. 98-2], 225–226.
[71] 11 USC §§ 1519(a), 1520(a), 1521(a).
[72] See Fed R Bankr P 9008.
[73] *Chemetron Corp v Jones*, 72 F3d 341, 349 (3d Cir 1995).

distribution in the foreign proceeding unless US creditors will be "sufficiently protected".[74] Moreover, US creditors also have the right to commence an involuntary case against US entities in the corporate group under Chapters 7 or 11, although if a Chapter 15 case was previously opened the presiding US bankruptcy court does have the discretion to stay that right under appropriate circumstances.[75]

5. Consolidation of assets

5.1 Procedure with respect to the sale of the whole or part of a business

In a bankruptcy case filed under Chapter 11 of the US Bankruptcy Code, a debtor in possession (or a trustee if the debtor is no longer in possession) may sell all or any portion of its assets (including business units as going concerns) outside of the ordinary course of business in two ways: (i) pursuant to section 363 of the Bankruptcy Code (a 363 sale); or (ii) pursuant to a Chapter 11 plan of reorganisation (a plan sale).

5.1.1 363 sales

Typically, 363 sales are accomplished via the filing of a motion with the bankruptcy court on 21 days' notice. Creditors are not entitled to vote on a 363 sale, assuming such a sale is effectuated outside the contours of a Chapter 11 plan of reorganisation. Although creditors and certain parties-in-interest may object to a 363 sale and present their arguments against such sale at a hearing, a court is generally obligated to overrule these objections if the debtor establishes: (i) a business justification for the sale; (ii) that the purchase price is fair and reasonable; (iii) that proper notice of the sale has been provided; and (iv) that the purchaser is proceeding in good faith.[76] The standard for court approval does not change if the assets being sold are jointly owned by multiple debtors or if the assets of multiple debtors are being sold together.

Courts tend to scrutinise the business justification for a 363 sale more closely when the sale: (i) involves all or substantially all of the debtor's assets; and (ii) is accomplished outside of a Chapter 11 plan of reorganisation and, therefore, avoids the voting requirements attendant to confirmation of a Chapter 11 plan (discussed below).[77] Nevertheless, 363 sales of all or substantially all of a corporate group's assets prior to confirmation of a Chapter 11 plan are routinely approved by US bankruptcy courts.

5.1.2 Plan sales

A plan sale is effectuated pursuant to a debtor's Chapter 11 plan of reorganisation.

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[74] 11 USC § 1522. See e.g. *In re International Banking Corp BSC*, 439 BR 614, 627–629 (Bankr SDNY 2010) (denying, without prejudice, the motion of foreign representative seeking turnover of funds in a US account subject to attachments obtained by US creditors on the basis that the foreign representative failed to establish that US creditors' interests would be sufficiently protected in foreign proceeding).

[75] *In re RHTC Liquidating Co*, 424 B.R. 714, 729 (Bankr WD Pa 2010), certain creditors did exactly that. Specifically, the *RHTC* case involved an involuntary Chapter 7 case filed against a US entity, despite the prior Chapter 15 recognition of a Canadian proceeding that included both the US entity and its Canadian parent. The foreign representative in the Chapter 15 case challenged the involuntary Chapter 7 filing, but the US court overruled this challenge in light of: (i) misgivings as to the fairness of the Canadian proceeding *vis-à-vis* the creditors of the US entity; (ii) the existence of post-petition transfers made from the US entity to the Canadian entity; and (iii) the fact that the funds to be distributed in the Canadian proceeding derived mostly from the sale of US assets.

[76] See *In re Gen Motors Corp*, 407 B.R. 463, 493–494 (Bankr SDNY 2009), *aff'd in part*, *In re Motors Liquidation Co,* 829 F3d 135 (2d Cir 2016).

[77] *Ibid.*

Under section 1129 of the US Bankruptcy Code, a plan can be confirmed consensually or non-consensually. To be consensual, section 1129(a) requires that every class of claims impaired by the plan – i.e. claims that will not be paid full as and when they would have become due had the bankruptcy not intervened – must vote to accept the plan.

Under the voting requirements of section 1126(c), a class of claims is deemed to accept the plan when it is approved by a vote of creditors holding at least 51% in number and constituting at least 66% of the dollar amount of the claims in that class. When one or more class of creditors vote to reject the plan, it can still be confirmed non-consensually (i.e. through a cram down), provided the plan: (i) is accepted by at least one impaired class; (ii) does not unfairly discriminate against any class of creditors; and (iii) is fair and equitable.[78]

363 sales may also be pursued in Chapter 7 liquidation cases. Indeed, 363 sales are consistent with one of the Chapter 7 trustee's primary duties, which is "to collect and reduce to money the property of the estate … and close such estate as expeditiously as is compatible with the best interests of parties in interest".[79] Generally, the standard for approval of a 363 sale in Chapter 7 is the same standard applicable in Chapter 11.[80] A Chapter 7 trustee may not pursue a plan sale, as plans of reorganisation are not available in Chapter 7.

5.2 Difference in treatment with respect to tangible and intangible assets

Generally, the US law discussed herein concerning the consolidation of legal entities and the disposition of consolidated assets does not change depending on the type of assets that are consolidated or sold, assuming the applicable debtors are not regulated entities (e.g. broker-dealers).

5.3 Role of creditors and creditors' committees in a substantive consolidation

A court can order the substantive consolidation of debtors' estates prior to confirmation of a Chapter 11 plan and, therefore, without a vote of creditors. Such relief, however, is rarely ordered. It is more common for a court to order substantive consolidation in connection with a Chapter 11 plan of reorganisation. As noted, under the cram down provision in section 1129(a)(10) of the US Bankruptcy Code, a plan of reorganisation, including a plan involving substantive consolidation, can be confirmed over the objection of an impaired class of creditors provided that, among other things, at least one impaired accepting class has voted in favour of the plan. Security holders and priority creditors and ordinary creditors are typically placed into different voting classes under a Chapter 11 plan because of their different rights, so that security holders can demand to receive the value of their collateral and priority creditors can demand to have their priority claims paid in full before any payment is made on account of non-priority claims. But none of these creditors are given greater voting rights than ordinary creditors, *per se*. For example, security holders whose collateral is insufficient to cover the full amount of their claims often have their unsecured deficiency claims classified together with other non-priority unsecured creditors. In any event, regardless of the type of creditor or claim involved, any impaired class of claims that votes to accept a plan by requisite majorities of its non-

[78] 11 USC § 1129(b).
[79] 11 USC § 704(a)(1).
[80] See *In re Childers*, 526 BR 608, 613 (Bankr DSC 2015); *In re Shipman*, 344 BR 493, 495 (Bankr ND W Va 2006); *In re Bakalis*, 220 BR 525, 532 (Bankr EDNY 1998).

insider creditors can be used as the basis to cram down the plan on other dissenting classes.

Although the relatively few US courts to address the issue have reached opposite conclusions, the apparent majority view is that US bankruptcy courts agree that "it is appropriate to test compliance with section 1129(a)(10) on a per-plan basis, not … on a per-debtor basis".[81] This means that, for a cram down plan involving multiple debtors, the plan proponents would need to show only that a single impaired class of creditors under the consolidated plan voted in favour of the plan and not that an impaired class of creditors of each debtor voted in favour of the plan.[82] As a result, it is possible that a plan providing for substantive consolidation could be confirmed, even where all the creditors of one the legal entities to be consolidated voted unanimously against the consolidation.

In most large corporate group Chapter 11 cases, a single official committee of unsecured creditors represents the interests of all unsecured creditors throughout the debtor group. In those cases in which the interests of creditors of one debtor or group of debtors within the overall corporate group substantially conflict with the interests of creditors of another debtor or debtor group, multiple official committees will sometimes (but not always) be appointed. When they are not, *ad hoc* creditor groups often form to voice the positions of creditors on each side of the conflict.

5.4 Voting for or against a substantive consolidation

Creditors are not entitled to vote on substantive consolidation unless it is part of a Chapter 11 plan, as set forth above. A class of creditors that would do better in a proposed Chapter 11 plan than they would in a liquidation is generally entitled to vote on the plan, even if such creditors would have received nothing in a liquidation.[83] However, a vote against the plan by such a class of creditors would not prevent the plan from being confirmed, so long as the cram down requirements are met, along with the other requirements for confirmation of a Chapter 11 plan. One such requirement is the "best interests of creditors" test, which, as a general matter, mandates that, with respect to each impaired class of creditors, each holder of a claim: (i) has accepted the plan; or (ii) will receive or retain under the plan property of a value that is not less than the amount such holder would receive if the debtor were liquidated under Chapter 7 of the US Bankruptcy Code.[84]

6. Equitable distribution and accountability of IPs

Regardless of the result of a US bankruptcy case, an IP cannot be held liable absent the commission of a tort, such as professional malpractice. Further, the purpose of Chapter 11 of the US Bankruptcy Code is reorganisation, and many successful

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[81] *In re Charter Commc'ns*, 419 BR 221, 266 (Bankr SDNY 2009) (citing numerous examples of joint Chapter 11 plans that were confirmed without each debtor having an impaired accepting class). The only Court of Appeals decision to address the issue agreed with this view: see *Matter of Transwest Resort Properties, Inc.*, 881 F.3d 724, 729–30 (9th Cir. 2018); but note in contrast *In re Tribune Co*, 464 BR 126, 183 (Bankr D Del 2011) (refusing to follow *Charter Commc'ns* and holding that the impaired accepting class requirement for Chapter 11 confirmation applied on a debtor-by-debtor basis even where a single plan provided for the reorganisation of multiple corporate group debtors).

[82] *See In re Woodbridge Group of Companies, LLC*, 592 B.R. 761, 778 (Bankr. D. Del. 2018) (This Plan provides for substantive consolidation; therefore, acceptance by one impaired class satisfied § 1129(a)(10)).

[83] Creditors are deemed to reject a Chapter 11 plan if the plan does not provide them with a recovery.

[84] 11 USC § 1129(a)(7)(A).

Chapter 11 reorganisations are accomplished via cram down, a debt-for-equity exchange or a combination of both. Many stakeholders in distressed US companies (and their IPs) prefer the speed and relatively small expense of a "pre-packaged" Chapter 11 case in which a debtor files for bankruptcy with a fully negotiated plan of reorganisation and with corresponding lockup agreements from major creditor groups that ensure the plan's approval. Although pre-packaged plans generally leave ordinary unsecured creditors unimpaired, they often involve a debt-for-equity or other exchange of senior indebtedness.

7. Intercompany claims

7.1 Order of priority

Valid intercompany claims are entitled to the same treatment as third-party claims in terms of priority and the amount of distribution they should receive. Intercompany claimants are, however, treated differently for the purpose of voting on a plan of reorganisation. For a cram down plan to be confirmed, it must be approved, without counting votes cast by insiders, by at least one class of "impaired" claims – that is, claimants whose rights are altered by the terms of the plan.[85] Thus, a plan cannot be confirmed based solely on the approval of corporate insiders.

7.2 Concepts that can alter priority

Recharacterisation and equitable subordination are both available as remedies in US bankruptcy cases with respect to all debt, including intercompany claims.

Recharacterisation is not expressly provided for in the US Bankruptcy Code. Nevertheless, US bankruptcy courts may invoke this equitable remedy to "recharacterise" a purported debt claim as an equity ownership interest in the debtor.[86] If recharacterisation is granted, the claims asserted by the purported debt holder will be treated instead as equity interests for all purposes under the US Bankruptcy Code, including for the purpose of distribution. In deciding whether recharacterisation is appropriate, US courts consider a number of factors to determine whether the parties intended for the investment to be: (i) a financing; or (ii) an equity investment disguised as a financing. Intent "may be inferred from what the parties say in their contracts, from what they do through their actions, and from the economic reality of the surrounding circumstances".[87]

Section 510(c) of the US Bankruptcy Code provides for the remedy of equitable subordination, although its contours are supplied by case law. A court can use equitable subordination to reorder the payment priority of an otherwise legitimate claim if fairness demands that such a claim falls behind those of other claimants.[88] When determining whether all or part of a claim should be equitably subordinated, US courts typically require a showing that the creditor holding such a claim engaged in inequitable conduct – such as lack of good faith by a fiduciary, fraud or unjust enrichment – and that such conduct either injured other creditors or provided the

[85] 11 USC §§ 1124, 1129(a)(10).
[86] *In re SubMicron Sys Corp*, 432 F3d 448, 456 (3d Cir 2006) ("[T]he focus of the recharacterisation inquiry is whether 'a debt actually exists', or, put another way … what is the proper characterisation in the first instance of an investment").
[87] *Idem*, 454. See also *In re AutoStyle Plastics, Inc*, 269 F3d 726, 749 (6th Cir 2001).
[88] *SubMicron*, 432 F3d, 454.

offending creditor with an unfair advantage.[89] Most cases of equitable subordination are brought against creditors who are corporate insiders, and, in such cases, the party seeking equitable subordination must present "material evidence" of the insider-creditor's inequitable conduct to shift the burden to the claimant, which then must demonstrate that its conduct was fair.[90] In cases brought against non-insider creditors, courts impose a higher burden of proof as to the alleged misconduct which is rarely satisfied, and thus equitable subordination against true third-party creditors is rarely granted.[91]

8. Administering a complex estate in one single consolidated procedure

More than one group can exist within an enterprise group for insolvency purposes and the US bankruptcy regime is capable of handling multi-corporate group cases. US bankruptcy judges, especially those in key US districts such as Delaware, the Southern District of New York and the Southern District of Texas, are accustomed to managing reorganisations of large and complex companies with numerous operating subsidiary groups.

Further, the complexity of a corporate group does not serve as a barrier or limitation to the application of the modified universalism rules codified by Chapter 15 of the US Bankruptcy Code.

9. Handling an insolvent parent with a healthy subsidiary

Regarding procedural consolidation, it is possible under US bankruptcy law for a solvent subsidiary to open its own bankruptcy case and have it jointly administered with the cases of its insolvent affiliates within the same enterprise group. There is no insolvency prerequisite for any corporate group member to open a US bankruptcy case.[92] Moreover, because Chapter 11 debtors remain in possession of their assets (unless and until a trustee is appointed for cause), an insolvent member of the corporate group will continue to exercise the same shareholder rights it had outside of Chapter 11 with respect to any of its wholly owned solvent subsidiaries, including influence or control over the decision whether those subsidiaries will enter bankruptcy as well.

For example, in the Chapter 11 cases of General Growth Properties Inc (GGP) and its affiliates, GGP caused 166 solvent subsidiaries to file for Chapter 11.[93] In these circumstances, creditors may move to dismiss the Chapter 11 case of a solvent debtor on the ground that it was opened in bad faith. The success of any such motion will be highly dependent on the facts of the case. Indeed, some courts, including the

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89 See e.g. *Benjamin v Diamond* (*In re Mobile Steel Co*), 563 F2d 692, 700 (5th Cir 1977); *In re Verestar, Inc*, 343 BR 444, 460–461 (Bankr SDNY 2006).

90 *US v State St Bank & Trust Co*, 520 BR 29, 80 (Bankr D Del 2014).

91 *In re Granite Partners, LP*, 210 BR 508, 515 (Bankr SDNY 1997) ("Where non-insider, non-fiduciary claims are involved, the level of pleading and proof is even higher. Although courts now agree that equitable subordination can apply to an ordinary creditor, the circumstances are few and far between") (citations and internal quotation marks omitted).

92 11 USC 109; *In re Marshall*, 300 BR 507, 510 (Bankr CD Cal 2003) ("As a statutory matter, it is clear that the bankruptcy law does not require that a bankruptcy debtor be insolvent, either in the balance sheet sense (more liabilities than assets) or in the liquidity sense (unable to pay the debtor's debts as they come due), to file a Chapter 11 case or proceed to the confirmation of a plan of reorganisation").

93 Each subsidiary was a special purpose entity that owned a separate shopping mall. *In re Gen Growth Properties, Inc*, 409 B.R. 43, 55 (Bankr SDNY 2009) (refusing to dismiss the solvent subsidiaries' bankruptcy cases on the grounds that they were filed in bad faith).

presiding court in GGP's bankruptcy, have held that a case should not be dismissed unless the party challenging the bankruptcy petition establishes, as a factual matter, both subjective bad faith in the filing of the petition and objective futility in the reorganisation process.[94]

Substantive consolidation of a solvent subsidiary into the bankruptcy estate of an insolvent enterprise group is a separate issue. Such consolidation, although theoretically possible, is exceedingly unlikely to be ordered. As discussed previously, one of the more recent and popular tests permits substantive consolidation only upon proof that: (i) prior to bankruptcy creditors extended credit in reliance on the corporate group as a whole, rather than on the separate assets and liabilities of individual members of the group; or (ii) the books, records and financial affairs of members of the corporate group are so commingled that untangling them during the bankruptcy would be costly and leave all creditors worse off.[95] By definition, creditors of a solvent debtor within a corporate group will be worse off if its assets and liabilities are combined with those of its insolvent group affiliates except in the rare circumstance the combined assets of the group are sufficient to satisfy all group liabilities. Therefore, the likely focus of a challenged request for substantive consolidation will be whether creditors of a solvent group entity relied upon that entity's separateness from the group as a whole.

Most sophisticated corporate group lenders will take steps before extending financing that demonstrate their reliance on the separateness of each obligor (i.e. the borrower and each guarantor). For example, covenants within contemporary US corporate financing agreements typically restrict the transfer of assets: (i) outside of the obligor group above a capped aggregate value; and (ii) between entities within the obligor group unless appropriate formalities respecting corporate separateness are maintained.

Nevertheless, lenders may be exposed to an attempt to substantively consolidate the obligor group in bankruptcy if they fail to negotiate these contractual protections or conduct appropriate diligence in advance of lending. The much more likely scenario in which creditor reliance may be in dispute is when separateness within the corporate group is hidden or obscured by a borrower perpetuating a Ponzi scheme or other fraud. In that scenario, a request for substantive consolidation of solvent and insolvent corporate group members may gain traction, especially if corporate separateness was equally hidden from creditors of insolvent group members.

[94] *Ibid* (citing *In re Kingston Square Assocs,* 214 BR 713, 725 (Bankr SDNY1997)).
[95] *In re Owens Corning*, 419 F3d 195, 211 (3d Cir 2005).

BREXIT: IMPLICATIONS FOR GROUP RESTRUCTURING AND INSOLVENCY PROCEEDINGS

1. Introduction

For more than 20 years, insolvency proceedings of transnational corporate groups with subsidiaries in Europe have anchored in London. In prominent cases, such as *Nortel Networks*,[1] subsidiaries in Europe, the Middle East and Asia (EMEA) found themselves centred in London. This practice has been built on the premise that proceedings in an English court, in particular, administrators appointed and decisions issued by such a court, are routinely recognised and implemented in those jurisdictions where assets, factories and workforces of the subsidiaries are situated.

Brexit is a challenge to this premise. The United Kingdom (UK) left the European Union (EU) at midnight on 31 January 2020. With the expiration of a transitional period on 31 December 2020, EU rules are no longer applied in English courts unless they were specifically incorporated into English law.

Even more importantly, the UK is no longer a Member State of the EU whenever EU law is applied in the EU. English courts therefore find themselves outside the territorial scope of EU regulations relevant for the handling of distressed corporate groups. Neither the provisions of the European Insolvency Regulation (EIR)[2] nor those of the Judgment Regulation (JR)[3] may serve to authorise English courts to open procedures or issue decisions anymore. At the same time, the EU-UK Trade Agreement[4] contains no legal instrument that may serve as a replacement by covering cross-border effects of civil or commercial procedures in (almost) all EU Member States. With the dawn of 2021, European legal practice suffered a sectoral "hard Brexit".

It remains to be seen whether this cessation of key legal instruments is capable of changing established practices in the restructuring and insolvency cases of international corporate groups. There are several reasons to suggest that London will remain the key EMEA hub for preventive group *restructurings*, but less for group *insolvency* cases.

2. Preventive restructuring of group financing

In recent years, financially troubled corporate groups from all over the world have routinely used the means of English schemes of arrangement, regulated in Part 26 of the UK Companies Act 2006, to restructure their debt (outlined in detail in the UK chapter of this book). The rise of the scheme can be traced back to three key elements, which are mostly still available in 2021. These elements are outlined below.

2.1 A welcoming and experienced bench

The High Court in London has convened hearings and confirmed schemes based on a welcoming construction of jurisdictional rules. As schemes are not listed in Annex A of the EIR, foreign companies find no need to establish an English centre of main interests (COMI). Instead, the courts have applied the "sufficient connection" test to foreign companies and have routinely found such a connection in English choice of law and jurisdiction clauses, even if these were amended only recently in order to establish such a connection for the purpose of a debt restructuring (as discussed in

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1 *Re Nortel Networks SA & Ors* [2009] EWHC 206 (Ch).
2 Council Regulation (EC) No 1346/*2000* of 29 May *2000* on insolvency proceedings.
3 Regulation (EU) No 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters.
4 EU-UK Trade and Cooperation Agreement of 30 December 2020.

the UK chapter of this book, with reference to cases such as *Re Codere Finance (UK) Ltd*[5] and *Re Apcoa Parking Holdings GmbH*).[6]

The broad interpretation of grounds for international jurisdiction by English courts is carried by the belief of the judges that the forum choice they enable is "good forum shopping". In cases where the use of an English scheme of arrangement is the only option to preserve a company (and the group it belongs to) from bankruptcy because similar instruments are not available in the law and practice of their original jurisdiction, the use of a scheme may achieve the best possible outcome, not just for the debtor and its group but also for creditors (noted in the UK chapter of this book).

It is fair to assume that this attitude will not be jolted by the mere fact that many countries, in particular in the EU when implementing the preventive framework of the EU Restructuring Directive 2019,[7] have adopted preventive debt restructuring mechanisms to assist local companies in financial distress. Indeed, the fact that foreign companies appear before English courts seems to prove that the law available at home is still either insufficiently drafted or inefficiently applied in practice, which in turn identifies a case of good forum shopping.

The underlying wish of stakeholders to use an English scheme rather than relying (solely) on local court assistance can be traced back to three peculiarities: the English language, English law-governed debt, and the expertise of English judges in both.

The English language is the language of international finance and law today. When seeking court assistance and offered a forum choice, stakeholders would naturally tend to favour a bench where proceedings are conducted in English, and judges are expected to naturally understand financial documents. This bias has effectively limited the circle of countries, which currently compete with the UK and United States (US) courts as international restructuring hubs, to countries with an English or Commonwealth heritage and a specialised commercial court (Ireland, Singapore, Australia). In contrast, recent attempts to establish English-speaking chambers in courts in Paris or Amsterdam have not yet shown much success.

English courts further benefit from the fact that many loan agreements used in connection with the finance of foreign companies and groups consist of Loan Market Association standard forms, which include English choice of law and jurisdiction clauses. As such clauses provide jurisdiction for schemes (on the basis of there being a sufficient connection), it seems natural to consider using a scheme in case of financial distress. English courts would even *require* foreign stakeholders to restructure English law-governed debt if the debt modification would need to be effective in the UK (the rule in *Gibbs*).[8] Parties would need to amend the choice of law clause to even avoid using a scheme.

Finally, and probably most importantly, English courts combine the advantages of language skills and choice of law clauses in financial documents with evident experience in restructuring practice, from where they commonly go to the bench. English judges in scheme proceedings can be expected to not only understand, but

5 [2015] EWHC 3778 (Ch).
6 [2014] EWHC 3849 (Ch).
7 Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019.
8 See the original decision *Antony Gibbs & Sons v La Société Industrielle et Commerciale des Métaux* [1890] 25 QBD 399, which was restated in *Bakhshiyeva v Sberbank of Russia & Ors* [2018] EWHC 59 (Ch); confirmed on appeal in *Re OJSC International Bank of Azerbaijan* [2019] Bus LR 1130.

also feel "at home" in financial documents and resulting complex debt structures. Based on such experience, they show a business-friendly bias when asked to accept new developments in scheme practice.

2.2 Third-party releases and intra-group guarantees

The second key element favouring the use of a scheme of arrangement when restructuring the debts of a corporate group is the availability of a broad third-party release. Group financing agreements are routinely secured by guarantees of group companies other than the principal debtor entity. Modifying claims against the debtor achieves little relief for the group unless the modification extends to creditor claims against the guarantors.

English courts have always expressed a favourable view of such extensions. In the eyes of the court, the release of contractual rights against related parties should be available where it is necessary "to give effect to the arrangement proposed for the disposition of the debts and liabilities of the company to its own creditors".[9] The release of third parties does not require any jurisdictional connection to the UK under this "necessity doctrine". In one case, it was even found irrelevant whether the scheme was used by the principal debtor or the guarantor when a guarantor scheme contained a release of the principal (foreign) debtor.[10]

The flexible approach of English courts enables corporate groups to address their financial troubles with a "single point of entry" (SPOE) approach in an English courtroom. Parallel procedures for guarantor entities are not even needed as long as the scheme of one group entity is able to also release all others, regardless of their COMI or place of incorporation.

The SPOE approach is not available in such a comfortable way in most jurisdictions. Germany may be the only other country where a release of rights against other group entities, even if foreign, has been available since 2021 based on the consent of the released group entity and the adequate protection of secured creditors.[11] The new Dutch Scheme would require a jurisdiction test to be met for the released group entity.[12] Remarkably, such releases are not available as such under Chapter 11 of the US Bankruptcy Code, although the recognition of schemes containing releases seems possible under Chapter 15.[13]

2.3 Schemes and "super schemes"

The third key element, and the only one adversely affected by the "hard Brexit" with regard to EU Member States, is recognition. English courts have always conditioned the availability of a scheme for foreign companies upon the fact that the relevant foreign courts would recognise the scheme (see the UK chapter of this book, referring

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[9] *Re Lehman Brothers International (Europe) (No 2)* [2010] Bus LR 489, [65]; confirmed in *Re Noble Group Ltd* [2019] BCC 349 [24]; *Gategroup Guarantee Ltd*, [2021] EWHC 304 (Ch); even extended beyond related parties in *In re Lecta Paper UK Ltd* [2020] EWHC 382 (Ch).

[10] *Re Swissport Fuelling Ltd* [2020] EWHC 1499 (Ch).

[11] Both a Corporate Stabilisation and Restructuring Act (StaRUG) restructuring plan and an insolvency plan may contain such a release; see s 2(4) of the StaRUG and s 217(2) of the German Insolvency Code (*Insolvenzordnung*) (InsO).

[12] This test would require a sufficient connection: see s 72 of the Dutch Bankruptcy Code.

[13] *In re Avanti Communications Group plc*, 582 BR 603 (Bankr SDNY 2018); *In re Agrokor dd*, 591 BR 163 (Bankr SDNY 2018). Recognition was refused, however, in *In re Vitro, SAB de CV*, 473 BR 117 (Bankr ND Tex 2012).

to the decision of Snowden J in *Re Van Gansewinkel Groep BV*),[14] either by recognising the judgment confirming the scheme or by accepting the substantive effects of the scheme as a means of debt modification under English law.

For companies from EU Member States, the recognition of the English judgment can neither follow from an application of the EIR[15] nor the JR[16] anymore. As for companies outside the EU, a judgment recognition needs to look at autonomous legal instruments found in applicable conventions (e.g. the Lugano Convention once the UK accedes, or the Hague Convention on Choice of Law Agreements), bilateral treaties or domestic rules on recognition in the host jurisdiction.

The relevant instruments commonly differ in scope between rules for the recognition of insolvency proceedings (and related judgments) and rules for the recognition of judgments in civil or commercial matters. The threshold found in these rules often differs significantly. The recognition of foreign insolvency proceedings is often facilitated by some form of a COMI-based jurisdiction test where local laws have adopted the United Nations Commission on International Trade Law Model Law on Cross-Border Insolvency (Model Law) or follow an even more universalist approach (as, for instance, Germany). The recognition of a civil or commercial judgment may depend on higher thresholds including, for instance, the proof of reciprocity. In other jurisdictions, rules may facilitate the recognition, especially because they provide no relevance to the debtor's COMI (see, for example, the Lugano Convention).[17]Overall, the landscape is colourful, and recognitions may depend on the peculiarities in the target jurisdiction.

The attraction of English schemes has never suffered from these complexities. Judgments sanctioning them were recognised in the EU as commercial judgments under the JR,[18] while US courts applied the rules for recognising foreign insolvency proceedings in Chapter 15 of the US Bankruptcy Code.[19] While the definition of insolvency proceedings and thus the scope of the respective recognition regime may significantly differ among jurisdictions, a judgment recognition has often been achieved.

Today's English restructuring practice is well aware of these complexities and has seized the opportunity to further enhance its restructuring toolbox with the "restructuring plan" – introduced in 2020 in a new Part 26A of the Companies Act 2006.

This new "super scheme" adds a cross-class cram down to the traditional means and procedure of a UK scheme under the condition that the debtor "has encountered, or is likely to encounter, financial difficulties that are affecting, or will or may affect, its ability to carry on business as a going concern."[20]

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[14] [2015] EWHC 2151 (Ch).
[15] EIR, art 32.
[16] JR, art 36.
[17] Convention on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters, OJ L 339, 21.12.2007, 3-41.
[18] See for example the German Federal Supreme Civil Court (BGH) applying the JR and its grounds to refuse recognition in BGH, 15.2.2012 – IV ZR 194/09, NZI 2012, 425 (*Equitable Life*).
[19] *In re Ocean Rig UDW Inc*, 570 BR 687 (Bankr SDNY 2017); *In re Avanti Communications Group plc*, 582 BR 603 (Bankr SDNY 2018).
[20] Companies Act, s 901A(2).

This condition has led the High Court to conclude that the restructuring plan is structurally different to a scheme as it only applies to financially troubled companies and thus triggers the exception under the Lugano Convention for insolvency proceedings.[21] The judgment seems to open the door for financially distressed foreign companies to strategically cherry-pick a scheme or a restructuring plan with a view to the different cross-border regimes associated with them while offering (mainly) the same means. Where jurisdiction or recognition requirements in a case are better served by the cross-border insolvency framework, a restructuring plan should be used, while a scheme would be the preferred choice where jurisdiction should be independent of COMI, or other insolvency law-related troubles ought to be avoided (such as safeguards for lenders under the Cape Town Convention).[22]

English courts now seem determined to offer a choice of "schemes": one to target jurisdictions based on rules for the recognition of civil judgments and one to target jurisdictions based on cross-border insolvency frameworks. Both are able to implement a debt restructuring based on a SPOE approach in well-established procedural forms.

Finally, it should be recalled that both a scheme and a "super scheme" can effect a debt restructuring across borders independent of any recognition of the judgment confirming the scheme. As far as the restructured debt is governed by English law, any modification of the debt by means of English law, including a modification by way of any type of a scheme, would be respected globally under general principles of private international law and national rules reflecting them (see, for example, the Rome I Regulation for EU Member States). As long as lenders prefer English law to govern their loans or, at least, the restructuring of those loans, schemes are effective based on their substantive content.

Overall, the English preventive SPOE restructuring approach offered by experienced professionals remains an attractive option for companies in most EU Member States, especially corporate groups. Path dependency and English law-governed debt create an additional bias favouring the UK. At the same time, the hard Brexit causes stakeholders to closely reconsider the legal basis for international jurisdiction and recognition of English judgments. While details here are currently uncertain and country-specific, the newly offered selection between schemes and restructuring plans might assist stakeholders in finding a fitting option. However, this option will then have to compete with a number of new preventive restructuring options in the EU, some of them even in the home jurisdiction of a corporate group. A scheme strategy might eventually be outflanked when, taken together, the advantages of a restructuring at home or in neighbouring EU courts outweighs the troubles of "shopping" for a scheme restructuring across the Channel. It remains to be seen how new scheme-like options in the EU, in particular in Dutch or German law, are exercised and valued in practice.

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[21] *In the matter of Gategroup Guarantee Ltd* [2021] EWHC 304 (Ch).

[22] *In the matter of MAB Leasing Ltd* [2021] EWHC 379 (Ch). It remains to be seen whether the scheme will actually be able to circumvent the treaty's safeguards, in particular since the scheme is held to be an "insolvency proceeding" in the eyes of US courts when granting recognition under chapter 15 of the US Bankruptcy Code; see D L Lawton, S B Wolf and Bracewell, *The Thing About Schemes in the Scheme of Things: Recognition of Schemes of Arrangement Under Chapter 15 of the US Bankruptcy Code*, INSOL International Technical Series, Issue No 38, March 2018. The High Court in Malaysia denied such a petition, see *Re AirAsia X Berhad*, in the High Court of Malaya in Kuala Lumpur, in the Federal Territory, Malaysia (Commercial Division), originating summons no WA-24NCC-467-10/2020; judgment handed down 19 February 2021, [281]-[282].

2.4 Conclusion

From a global perspective, Brexit has not changed anything. Even from the EU perspective, the English restructuring instruments remain both attractive and available. English case law continues to develop the means available in a scheme of arrangement and a new restructuring plan and enables them to effect restructuring strategies, in particular for corporate groups, which are hardly available elsewhere. At the same time, the advantage of the English language and an experienced bench (informed by skilled professionals) could provide an advantage for the UK as a restructuring hub at least in the European area, if not globally, provided that recognition is available.

3. Parallel insolvency cases and synthetic proceedings

In the event of the bankruptcy of a corporate group, insolvency proceedings are commenced on an entity-by-entity approach. Transnational groups are thereby divided into multiple insolvency proceedings. Often the number of proceedings equals the number of insolvent entities. The task of maintaining the functions of the group – with a view to the synergies and value obtained by running the business as a group – falls into the hands of multiple courts and administrators. As it is difficult, if not impossible, to consolidate assets or proceedings across borders, a "multiple point of entry approach" is required. Coordination and cooperation between the administrators and courts in different jurisdictions replace the control mechanisms within the corporate group with a significant degree of imperfection.

3.1 Concentrating main proceedings for group entities

The common way of avoiding insolvency proceedings in multiple jurisdictions with the resultant loss of centralised control has been a coordinated and quick filing for insolvency proceedings in one jurisdiction for all group entities (of a region).

The success of such a strategy depends on the willingness of the local courts to accept international jurisdiction for all group entities. Under the EIR, English courts were notorious for allocating a group entity's COMI in England if needed. They followed a mind-of-management approach until the Court of Justice of the European Union (CJEU) rejected such an interpretation of the COMI requirement in article 3(1) of the EIR in the *Eurofood* decision,[23] which only resulted in English courts finding the COMI in England based on a more comprehensive review of all relevant criteria, including where *creditors* saw the COMI of the group entities.[24]

Brexit released the English courts from CJEU case law for determining COMI. *Eurofood* restrictions therefore no longer apply. Even more, the Insolvency Brexit Regulations extend the court's jurisdiction to any foreign company with a sufficient connection to the UK (as discussed in the UK chapter of this book). It is understood that English courts will continue to welcome the concentration of group insolvency proceedings as separate main proceedings under English insolvency law for group entities incorporated in the EU and the European Economic Area, but also in other regions in proximity within the EMEA if practical.

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[23] *Eurofood IFSC Ltd,* C-341/04, 2 May 2006, ECLI:EU:C:2006:281.

[24] *Thomas & another v Frogmore Real Estate Partners & others* [2017] EWHC 25 (Ch).

3.2 Recognition of English main proceedings abroad

The new post-Brexit freedom for English courts in handling jurisdiction comes at a significant cost in the area of recognition. With the UK considered a third state in the eyes of the remaining EU Member States, automatic recognition of English proceedings and administrators based on the EIR is denied. This is critical as the mechanics of the EIR have always allowed a court which is willing to accept jurisdiction rather broadly for foreign EU group entities to bind all other EU Member States' courts, provided that the proceedings are opened there first[25] and the opening decision is confirmed if appealed.[26] Effectively (with the notable exception of the *NIKI* case in Berlin),[27] these mechanics enabled EU courts to concentrate proceedings in the court where the EU holding company is located whenever motions to open proceedings for all group entities across Europe were first filed there. This mechanism is now lost for English courts due to Brexit.

It is difficult to assess what this means for the UK as a place to concentrate the EU / EMEA arm of global insolvencies as we saw them in *Nortel Networks*. A legal instrument mirroring the effects available pursuant to the EIR is not in sight. Recognition of insolvency proceedings in the UK would need to be achieved in each EU Member State based on local laws. Yet the rules in these states differ in many ways. Some countries may not even feature a cross-border insolvency regime outside the EIR (such as the Baltic States). Few have modelled any rules that do exist on the Model Law (which has only been adopted by Greece, Poland, Romania and Slovenia, as well as Israel, Serbia and Montenegro in the broader area). Others provide rather specific frameworks, such as Germany.[28] All of them will condition recognition on a second assessment of the debtor's COMI or a similar jurisdiction test based on local law. Any broad approach to jurisdiction concerning foreign companies finds its limits here.

On the other hand, the advantages of a common language, professional institutions and courts willing to cooperate, mentioned for schemes above, remain relevant and could suffice for attracting group proceedings. Further, the advantages of the EIR mechanics have always been compromised by the availability of territorial secondary proceedings pursuant to article 3(2) of the EIR – which commonly resulted in parallel proceedings in England and in the places where group entities operate. The need to coordinate centralised (main) with local (non-main) proceedings has always characterised transnational group insolvency cases unless the commencement of the latter was prevented.

Overall, the situation is difficult to assess and may turn out to be rather case-sensitive. Whenever group entities have their COMI in EU (and non-EU) jurisdictions with a predictable legal framework for recognition and a sense for accepting a centralising COMI assessment in the UK, Brexit may not change much, and the proceedings may well be concentrated in an English court. However, if recognition is not achievable in key jurisdictions, parallel (main) proceedings will be needed and should be concentrated in an EU Member State offering similar welcoming and professional institutions. Ireland or the Netherlands come to mind, and possibly also Germany.

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[25] EIR, art 19.
[26] EIR, art 5.
[27] See LG Berlin, 8.1.2018 – 84 T 2/18, ZIP 2018, 140.
[28] S Madaus, A Wilke and P Knauth, "Bringing Non-EU Insolvencies to Germany: Really so Different from the UNCITRAL Model Law on Cross-Border Insolvency?" (2020) 17(1) *International Corporate Rescue* 21.

3.3 Preventing the uncoordinated commencement of parallel proceedings

Faced with the prospect that there is no legal instrument which could prevent the commencement of parallel proceedings in COMI jurisdictions of group entities, insolvency practice might reconsider an informal approach that was created in the early 2000s with a view to minimise the damaging effect of such additional procedures: the undertaking.

Similar to the situation post-Brexit, English administrators of the 2000s found themselves able to be appointed as "joint administrator" for all EU group entities by an English court based on a pragmatic assessment of the entities' COMI, but the opening of main proceedings in the UK did not prevent the opening of secondary proceedings in the countries where the subsidiaries were incorporated and, sometimes, most of the group's assets were located.

Secondary proceedings under local law secured preferred creditor status to certain classes of local creditors (such as employees and tax authorities) and enabled local creditors to become formally involved in the administration of the group's affairs, for example by forming a creditors' committee. Hence, such proceedings were commonly commenced. From a UK perspective, however, the involvement of (potentially several) secondary proceedings jeopardised the very group-level control that had otherwise been preserved by filing all group cases in the UK. Any group-wide solution, such as a going-concern sale or a reorganisation of the group, would be difficult, if not impossible, to achieve once such additional territorial proceedings were commenced.

With no legal remedy at hand to prevent the opening of secondary proceedings, English insolvency administrators aimed to comfort local creditors in a way that would see them abstaining from initiating secondary proceedings. To achieve this, the administrators in the cases of *MG Rover*[29] and *Collins & Aikman*[30] promised local creditors, often employees, that the administrators would make payments in the UK main proceedings "equal to what [the local creditors] would have received in secondary proceedings commenced" at home.[31] As it turned out, local creditors put their trust in these assurances and, instead of initiating competing secondary proceedings, supported the group-oriented strategy of the joint administrators, who were able to achieve very favourable going-concern sales of the group. With the realised cash available, the administrators needed court permission for a distribution, which, as promised, would not only be guided by English insolvency law, but also by statutory priorities pursuant to foreign insolvency laws. English courts found the rules of the Insolvency Act 1986 sufficiently flexible to grant permission to a distribution as promised.[32]

With the practice of "virtual" or "synthetic" secondary proceedings put in place in the UK, English courts have been well-prepared to act as the EU hub for global group insolvencies. In the case of *Nortel Networks*, the strategy was complemented with letters of request sent by the English court to all potential foreign courts of secondary proceedings asking them to "put in place arrangements under which the joint administrators will be given notice of any request or application for the opening of

[29] *Re MG Rover Belux SA/NV,* 29.3.2006 (unreported in UK), reported in NZI 2006, 416 (Germany).
[30] *Collins & Aikman Europe SA Collins & Ors, Re Insolvency Act 1986* [2006] EWHC 1343 (Ch).
[31] See *MG Rover.* See also *Collins & Aikman,* 8.
[32] See *Collins & Aikman,* 27-29. See also *MG Rover*.

secondary insolvency proceedings in respect of any of the companies in administration".

The mere fact that the UK is a third state in the eyes of EU Member States' courts post-Brexit does not seem significant with regards to the practice of virtual proceedings. The ability of the English administrators to offer assurance to foreign creditors and give effect to this promise in a legal distribution has not changed, as it derives from English law. The promise given has never been legally binding or enforceable in the country of potential secondary proceedings. Its effects have always relied on the conviction of relevant local creditor classes that they would fare better in a centralised main procedure compared to a situation with a local secondary proceeding.

The inability to apply EU law might even work in favour of English courts as the assurance of the English administrator and its sanctioning by the courts would certainly not be affected by the conditions laid down in article 36 of the EIR. In a failed attempt to provide all courts in EU Member States with the power to sanction a distribution according to an undertaking in line with UK best practice, a bureaucratic obstacle appeared in article 36 of the EIR,[33] which made such assurances effectively impossible. The open question of whether article 36 of the EIR hinders any other form of assurance[34] has lost relevance for English courts now that the EIR is not applied anymore in the EU with regard to English insolvency proceedings.

The wish to be timeously notified and heard about the motion to open secondary proceedings by courts in the EU cannot rely on duties to cooperate among EU Member States' courts[35] anymore. English administrators need to follow a country-by-country analysis and hope to find bilateral agreements or national insolvency laws by which English proceedings are recognised and cooperation with English courts is authorised.[36]

While the practice of undertakings seems facilitated by Brexit, it must be remembered that such assurances are only a means to an end. The purpose of any undertaking is the wish to secure a group-wide solution implemented by the joint administrators in the (English) main proceedings. This requires the power of those proceedings and its administrators to transfer rights of the debtors located in foreign jurisdictions (such as assets and shares in subsidiaries) in the first place. Any re-invention of virtual secondary proceedings would be preconditioned on the fact that English main proceedings are even able to provide for such a pan-European administrative power, which in turn takes us back to the issue of recognition (discussed above).

Assurances are only relevant under the condition that English insolvency proceedings are recognised in countries of group entities as main proceedings and, thereby, are afforded assistance by authorising the English administrator to access local assets and register the transfer of shares in local companies. Where such recognition is either not available at all or, based on a divergent assessment of the entity's COMI in a recognition procedure, only available as a foreign non-main proceeding, the English

[33] While the initial proposal in the Commission's draft (art 18(1) sentences 3 and 4; COM(2012) 744 final, 25) was based on the English practice, the final version in art 36 of the EIR requires the undertaking to be legally binding and enforceable based on the acceptance of local creditors similar to a plan acceptance.

[34] For a discussion (in German), see Madaus, Die Zusicherung nach Art. 36 EuInsVO – Das Ende virtueller Sekundärinsolvenzverfahren?, Kayser/Smid/Riedemann (eds) Festschrift für Klaus Pannen, 2017, 223, 236-239.

[35] These are set out in EIR, art 42.

[36] In Germany, for instance, relevant provisions are found in ss 343 and 348(2) of the InsO.

administrator would not be able to act in relation to local assets. In such cases, any group-wide, value-maximising strategy would better anchor main proceedings in a EU Member State, ideally one with an insolvency regime flexible enough to imitate the English practice of a group COMI and virtual secondary proceedings. It remains to be seen whether the Netherlands, Malta or Ireland step up in this respect. German practice does not seem to be a likely candidate at present.

3.4 Conclusion

The future of the UK as the European hub for global group insolvency proceedings seems to solely depend on the issue of recognition as a foreign main proceeding in EU Member States and other European countries. Where such recognition is available, commonly based on an independent reassessment of the jurisdiction of English courts, the group-wide effects of a joint administration may well be secured by assurances of the English administrators (virtual secondary proceedings). Otherwise, entities of the group will find themselves placed in competing main proceedings with EU-wide effect only granted to the one in an EU Member State based on the EIR. Any parallel proceedings relevant for a group-wide strategy would need to be coordinated, but could not be concentrated in the UK. It remains to be seen whether court practice in an EU Member State will provide for more concentrated solutions in the tradition of English courts.

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