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Insolvency law

Possible future work in the area of insolvency law

Addendum

Proposal by International Association of Restructuring, Insolvency and Bankruptcy Professionals (INSOL)

Treatment of corporate groups in insolvency

A. Introduction

1. INSOL proposes that the United Nations Commission on International Trade Law (UNCITRAL) consider undertaking a project in the area of insolvency law and its effects upon the treatment of corporate groups and related companies when one or more of the members of such a group becomes insolvent.

2. In its work on the Legislative Guide on Insolvency Law, UNCITRAL recognized the importance of the issues relating to the treatment of corporate groups in insolvency and addressed them in part (Part two, chap. VI, paras. 82-92). It was also recognized, however, that the analysis of current treatment and identification of possible solutions would have undoubtedly distracted from the main body of work on the Legislative Guide. Accordingly, the subject was not pursued in any great detail and no recommendations were proposed.

3. The efficacy of insolvency laws and practices has been a recurring theme in, and major concern of, international forums since the early 1990s. Effective insolvency regimes are increasingly seen as a means of encouraging economic development and investment, as well as fostering entrepreneurial activity and the preserving of employment. Conducting business through the formation of corporate groups is a feature of the increasingly globalized world economy. They are

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significant to international trade and commerce with respect to, for example, the formation of overseas subsidiaries and joint ventures to manufacture, market and license products. Where business fails, it is important not only to know how those groups will be treated in insolvency proceedings, but also to ensure that that treatment facilitates, rather than hinders, the fast and efficient conduct of those proceedings.

B. Existing treatment of corporate groups in insolvency

Domestic insolvency law treatment

4. The great majority of domestic insolvency and corporate law regimes do not address the treatment of corporate groups in specific legislation or at all. In some others, the issues that arise in case of insolvencies within corporate groups are dealt with by somewhat "creative" practices that rely heavily on a pragmatic approach by the courts for their legitimation. For example, in both England and Australia, mechanisms have been developed that enable a "pooling agreement" to be sanctioned by the courts, whereby the assets and liabilities of two or more related companies in a group are, in effect, turned into one pool of assets and one pool of liabilities. The result is that the separate existence of all the companies that are subject to the pooling agreement is, in effect, ignored and all unsecured creditors of all companies participate equally in distributions from a single pool of assets. Case law in the United States of America follows a similar pattern.

5. The development of such case law has often involved a consideration of issues such as:

(a) Whether creditors have dealt with a group of companies as a single economic unit;

(b) Whether the affairs of the group are so entangled that a consolidation would benefit all creditors;

(c) Whether there has been misappropriation of the assets of one entity for the benefit of another; and

(d) A consideration of a balancing test that weighs up the costs and benefit of substantive consolidation.

The Netherlands is an example of a country without any legislative base but where, in a few cases, the courts have been prepared to permit a consolidation of assets and liabilities between insolvent companies in cases where, as mentioned above, the affairs and assets of the companies have been so intertwined that it is impossible to determine which company was the owner.

6. New Zealand does have some specific legislation within its insolvency law, which is principally based on providing a legislative sanction for the pragmatic practices used in other countries as mentioned above.

7. In addition, in Australia, the insolvency legislation provides for the liability of a holding (parent) company for the debts of a subsidiary company that became insolvent if it is established that the subsidiary was permitted by the parent to engage in insolvent trading. Australian legislation also provides for the avoidance,

in summary fashion, of pre-bankruptcy transactions entered into by an insolvent company with another company to which it is related.

Cross-border insolvency legislation

8. Cross-border multilateral treaty arrangements do not include provisions dealing with the issues in an international context. For example, neither the European Council Regulation No. 1346/2000 on Insolvency Proceedings nor the UNCITRAL Model Law on Cross-Border Insolvency addresses the issue.

9. There is, thus, at both a domestic and international level, a comparative absence of any guidelines as to the circumstances under which consolidated insolvency proceedings of companies belonging to a group should be considered in insolvency proceedings and how issues such as jurisdiction, filing, secondary proceedings and distribution should be addressed.

C. Jurisdictional factors for consideration

10. There are significant differences between jurisdictions in the way in which some of the issues arising need to be addressed. Among the varied factors of which account should be taken are:

(a) Differences in philosophy and approach between civil and common law traditions concerning management or "control" of corporate groups and related companies and in approaches to director responsibility and liability in the context of corporate groups;

(b) The extent to which the accounting aspects of the issues of groups of companies need to be considered in this context;

(c) The effect of tax legislation, the incidence of which is often the reason for the formation and subsequent growth of a corporate group and the adoption of strategies within the group;

(d) The extent to which inter-company pricing policies drive the consequent distribution of assets and liabilities within corporate groups;

(e) Potential conflict-of-interest issues and consolidated or main-type of proceedings; and

(f) The possible repercussions for secured transactions and secured creditors in the way in which corporate groups are treated in insolvency.

D. Scope of project

11. INSOL recognizes that different views of the scope of possible work could be taken. At a minimum, it could be strictly confined to establishing the circumstances in which, both in a domestic and cross-border situation, it might be desirable to promote legislation that:

(a) Allows the separate entity principle to be ignored or disregarded;

(b) Facilitates pooling of assets and liabilities of group companies; and

(c) Provides guidelines under which (a) and (b) might be achieved.

12. The scope could, however, be considerably wider and also possibly include the following:

(d) Guidelines allowing an insolvency representative in the insolvency of a holding company to steer the actions to be taken by the (insolvent) subsidiary;

(e) Guidelines for dealing with group companies in different jurisdictions, (by possibly adjusting, for example, the concept of centre of main interests for subsidiary or related companies);

(f) Guidelines that provide for more extensive powers on the part of an office holder to undo and avoid transactions between companies in a group that prejudice creditors; and

(g) Guidelines that, in certain circumstances, provide for a "parent" company to be liable for the debts of an insolvent subsidiary.

E. Role of UNCITRAL in undertaking further work on this topic

13. INSOL considers that UNCITRAL is eminently suited to carrying out a project of this complexity and wide-ranging significance. UNCITRAL has a proven track record in insolvency law work, developing both the Model Law on Cross-Border Insolvency and the Legislative Guide on Insolvency Law in comparatively short periods of time. Furthermore, in the course of developing both of these texts, UNCITRAL has formed links with key participants in the area of insolvency law, including Member and non-member States, intergovernmental and non-governmental organizations, as well as individual insolvency experts. Participants in the development of these texts have represented a broad cross-section of nations with different legal traditions and levels of economic development. The UNCITRAL secretariat and Member States are already familiar with many of the national policy issues related to insolvency.

14. Further work by UNCITRAL would not only advance agreement on the technical content that should be included in national approaches to treatment of corporate groups in insolvency, but would also heighten international awareness of the importance of the topic. That could raise the national priority given to implementing the necessary law reform.

F. Proposed study and colloquium

15. It is suggested that, as a first step, an in-depth study of different approaches to the treatment of corporate groups in insolvency would provide the means for identifying the issues that should be addressed to deliver predictability and transparency to the treatment of corporate groups in insolvency, as well as possible approaches and options for addressing those issues. Such a study would benefit from wide consultation to solicit views and consider, and possibly refine, potential scope, approaches and options.

16. That consultation might take the form of a multinational colloquium, a forum used to good effect in developing both the Model Law on Cross-Border Insolvency

and the Legislative Guide on Insolvency Law. The successful conclusion of that first step might indicate that a Working Group should be established to develop an appropriate text.

17. INSOL is willing to join with UNCITRAL in promoting the study and the discussion at a multinational colloquium to be convened in advance of a possible decision to establish a Working Group.