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# Treatment of corporate groups in insolvency

## Note by the Secretariat

Contents



V.07-81183 (E)

1. This note draws upon the material contained in A/CN.9/WG.V/WP.74 and Add.1 and 2, the UNCITRAL Legislative Guide on Insolvency Law (the Legislative Guide), the UNCITRAL Model Law on Cross-Border Insolvency (the Model Law), and the Report of Working Group V (Insolvency Law) on the work of its thirty-first session (A/CN.9/618). It has been prepared on the basis that the work on corporate groups will form a supplement to the Legislative Guide and therefore follows the format of the Legislative Guide, including both commentary and recommendations. Some explanatory notes on recommendations have also been included, but only for the information of the Working Group.

# I. Glossary

2. A glossary of terms relating to corporate groups is included in A/CN.9/WG.V/WP.74. The Working Group may wish to consider which of the explanations for a particular term contained in the Glossary in A/CN.9/WG.V/WP.74 would be the most appropriate for the purposes of revising the Glossary, along the lines of the Glossary contained in the Legislative Guide.

3. Additional terms could include the following:

**(a) Domestic corporate group**

A number of enterprises, including enterprises that are not necessarily incorporated, that: (a) are [associated by common or interlocking holdings or allied by control, including the capacity to control] [bound together by means of capital or control, including capacity to control]; and (b) organize and conduct their business in a coordinated manner. The capacity to control includes corporate groups based on a contractual arrangement.

**(b) International corporate group**

A number of enterprises, including enterprises that are not necessarily incorporated, that: (a) are subject, whether through incorporation, the conduct of economic activity, the presence of assets or some other test, to the legislation of different countries; (b) are [associated by common or interlocking holdings or allied by control, including the capacity to control] [bound together by means of capital or control, including capacity to control]; and (c) organize and conduct their business in a coordinated manner.

# II. Background

4. The Working Group may wish to consider whether the background material contained in document A/CN.9/WG.V/WP.74, which discusses the nature of corporate groups, reasons for conducting business through corporate groups, definition of the “corporate group” and regulation of corporate groups, could be expanded to reflect additional comparative material based on the practice of different jurisdictions and form the basis of a background chapter for the work to be developed on corporate groups.

# III. The onset of insolvency: domestic issues

## A. Commencement of proceedings

### 1. Commencement standards

[Reference: Legislative Guide: part two, chap. I, paras. 20-79 and recommendations 14-29]

5. The standard to be met for commencement of insolvency proceedings is central to the design of an insolvency law. As the basis for insolvency proceedings, that standard is instrumental to identifying the debtors that can be brought within the protective and disciplinary mechanisms of the insolvency law and determining who may make an application for commencement, whether the debtor, creditors or other parties. It will also affect the type of proceedings that can be brought against a debtor.

6. The Legislative Guide discusses issues relating to commencement of insolvency proceedings in some detail.[1] In general, the considerations identified as applying to commencement against a single debtor will apply in the corporate context, although some additional issues are raised below.

7. Many insolvency laws require a debtor to be insolvent (however defined) for commencement of insolvency proceedings. As a general rule, insolvency laws also respect the separate legal status of each member of a corporate group and a separate application for commencement of insolvency proceedings would therefore be required for each member of the group that satisfied the insolvency test. In that context, one issue of relevance to determining which members of a corporate group satisfy the test of insolvency is how various liabilities such as intra-group indebtedness and potential liabilities under a cross guarantee should be treated.

8. A second key issue in the treatment of corporate groups in insolvency is the degree to which the corporate group is economically and organizationally integrated and how that level of integration affects treatment of the group in insolvency and in particular, the extent to which a highly integrated group should be treated differently to a group where individual members retain a high degree of independence. In some cases, where for example the structure of a group is diverse, involving unrelated businesses and assets, the insolvency of one or more members of the group may not affect other members or the group as a whole and the insolvent members can be administered separately. In other cases, however, the insolvency of one member of a group may cause financial distress in other members or in the group as a whole, because of the group's integrated structure, with a high degree of interdependence and linked assets and debts between its different parts.

### 2. Persons permitted to apply

9. As a matter of general insolvency law, the Legislative Guide recommends that creditors and debtors should be permitted to make an application for commencement of insolvency proceedings, without distinguishing between liquidation and reorganization. Recommendation 14 provides:

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[1] UNCITRAL Legislative Guide, part two, chap. I.

"*14. The insolvency law should specify the persons permitted to make an application for commencement of insolvency proceedings, which should include the debtor and any of its creditors*.[2]"

*(a) Debtor application*

10. Irrespective of the level of integration of a group, an insolvency law may permit a number of insolvent members of the group to jointly apply for commencement of insolvency proceedings or permit applications already made to be joined, where members satisfy the commencement standard (either on the basis that they are already insolvent or likely to become insolvent, where imminent insolvency is a component of the commencement standard).

11. These possibilities would be within the scope of recommendation 15 of the Legislative Guide, which provides:

"*Debtor application*

*15. The insolvency law should specify that insolvency proceedings could be commenced on the application of a debtor if the debtor can show either that:*

*(a) It is or will be generally unable to pay its debts as they mature; or*

*(b) Its liabilities exceed the value of its assets*.[3]"

12. Recommendation 15 makes no distinction between liquidation and reorganization, referring only to insolvency proceedings. In the context of joint applications, recommendation 15 may be more appropriate to reorganization where it is key to the success of the reorganization that the financial circumstances of closely integrated members of the group be addressed in joint insolvency proceedings and possibly through the preparation of a single reorganization plan (see below). It may also be relevant in liquidation where it would facilitate administration of the proceedings to deal with assets together, such as where the insolvent members are closely integrated, or where certain units of the group can be sold as a going concern.

*(b) Applications with respect to a solvent group member*

13. Where a group is closely integrated, an insolvency law may also permit an application to include group members that do not satisfy the commencement standard, because it is desirable in the interests of the group as a whole that they be included in those proceedings. Such an application might be made by a parent in respect of subsidiary members of the group or by any member in respect of other members, including the parent. Consideration might also be given to permitting an application by an insolvency representative appointed to the insolvency of the parent, where it is determined to be necessary for the success of the proceedings

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[2] This would include a government authority that is a creditor of the debtor.

[3] The intention of this recommendation and the recommendation on creditor applications is to allow legislators flexibility in developing commencement standards, based on a single or dual test approach. Where the insolvency law adopts a single test, it should be based on the debtor's inability to pay debts as they mature (cessation of payments test) and not on the balance sheet test. Where the insolvency law contains both tests (cessation of payments and balance sheet tests), proceedings can be commenced if one of the tests can be satisfied.

affecting the parent to include other members of the group. Such an approach may facilitate the preparation of a comprehensive reorganization plan, addressing the assets of both solvent and insolvent members of a group. It could also facilitate development of an insolvency solution for the whole of the group, avoiding piecemeal commencement of proceedings over time, if and when additional members of the group became affected by the insolvency proceedings initiated against the originally insolvent members.

14. Factors relevant to determining whether the necessary degree of integration exists might include: that there is a relationship between the companies that is variously described, but involves, for example, a significant degree of interdependence or control; intermingling of assets; the fictitious nature of the group; unity of identity, reliance on management and financial support or other similar factors that need not necessarily arise from the legal relationship (such as parent-subsidiary) between the companies.

15. A joint application for commencement might also be permitted where all interested members of the group consent to the inclusion of one or more other members, whether they are insolvent or not, or all parties in interest, including creditors, so consented. An insolvency law might also consider whether a group member not involved at the time of commencement of insolvency proceedings against other members of the group might later be joined in those proceedings if it is subsequently affected by those proceedings or determined that its joinder would be in the interests of the group as a whole.

*(c) Creditor application*

16. Although, as noted above, recommendation 14 of the Legislative Guide recommends that both creditors and debtors should be permitted to apply for commencement of insolvency proceedings, without distinguishing between liquidation and reorganization, it also notes that a number of laws only permit debtor applications for reorganization. While there may be no reason to justify departure, in the case of a corporate group, from the general approach that recommends creditors be permitted to apply for commencement of both liquidation and reorganization, the structure of a corporate group may raise particular difficulties for creditors.[4] In some cases, especially where the group is loosely organized, the particular debtor may be easily identified. Where there is a high degree of integration, however, the issue may be less clear, especially where the creditor believed that it was dealing with the group as a single enterprise, and it may be particularly difficult for a creditor to identify the specific part of the group or a particular debtor with which it dealt and provide the evidence necessary to satisfy the commencement standard. For the same reasons, it might be difficult for a creditor to determine whether liquidation or reorganization proceedings would be more appropriate for a particular debtor where the insolvency law requires such a determination to be made at the time of the application.

17. If certain members of the group are not included in a debtor application under recommendation 15, they might subsequently be the subject of an application by

[4] UNCITRAL Legislative Guide, part two, chap. I, paras. 37-41 and 48-53, for a discussion of creditor applications.

creditors under recommendation 16, which could include a group member that was a creditor of an insolvent group member. Recommendation 16 provides:

"*Creditor application*

*16. The insolvency law should specify that insolvency proceedings could be commenced on the application of a creditor if it can be shown that either:*

*(a) The debtor is generally unable to pay its debts as they mature; or*

*(b) The debtor's liabilities exceed the value of its assets*."

*(d) Application by a government or regulatory authority*

18. The Legislative Guide discusses the issue of governmental or other supervisory authorities having the authority to apply for commencement of insolvency proceedings and concludes that such a power should only be available in very limited circumstances and only as a last resort in the absence of appropriate remedies under other laws (see part two, chap. I, paras. 42-44). The Legislative Guide outlines those circumstances and the desirability of limiting the use of such a power to applications for liquidation.

19. The same considerations would apply to applications by government or regulatory authorities for commencement of insolvency proceedings against two or more members of a corporate group.

**3. Notice of application and commencement**

*(a) Debtor application: notice to creditors*

20. Since the rights of creditors of each of the group members involved in a joint administration should not be altered without their agreement, it is desirable that an insolvency law include provisions requiring notice of the commencement of joint proceedings (where the application is made by one or more members of the corporate group) to be given to the creditors of all members involved in the insolvency proceedings. It may be desirable to require notice to be provided to the creditors of all members of the group, particularly where the group is closely integrated and the solvency of members not included in the proceedings may be influenced by the proceedings. Recommendations 24 and 25 of the Legislative Guide address the provision of notice on commencement of insolvency proceedings on an application by the debtor and should apply equally in the context of a corporate group. Creditors disputing issues of insolvency or objecting to joint administration could do so after commencement of the proceedings.

21. Additional information concerning the effect of joint administration could be added to the information to be provided under recommendation 25 of the Legislative Guide, particularly as it affects creditors. That information would be of particular importance to creditors of any solvent member of a group that was included in insolvency proceedings.

*(b) Creditor application: notice to the debtor*

22. Similarly, recommendation 19 of the Legislative Guide, concerning commencement on a creditor application, should apply in the group context, requiring notice of the application for commencement to be given to those members

of the corporate group included in the application, providing them with an opportunity to object. Consideration may also be given to whether notice should be given to members of the corporate group not included in the application, but which may nevertheless be affected by the insolvency proceedings.

***Recommendations***

*Commencement of insolvency proceedings: corporate groups*

(1) The insolvency law may permit a joint application for commencement of [insolvency] [reorganization] proceedings to be made by two or more members of a corporate group that satisfy the commencement standard in recommendation 15 of the Legislative Guide.

(2) The insolvency law may permit a joint application for commencement of [insolvency] [reorganization] proceedings to be made by two or more members of a corporate group provided one of them satisfies the commencement standard in recommendation 15 of the Legislative Guide.

(3) The insolvency law may permit an application for commencement of [insolvency] [reorganization] proceedings by [one or more members] [the parent] of a corporate group that satisf[y][ies] the commencement standard of recommendation 15 to be extended to include one or more [members] [subsidiaries] of the group that do not satisfy that standard, where:

(a) [The members to which the application is to be extended] [all members of the group] [creditors of the group member to be included] [all interested parties] consent; or

(b) The court determines that the members of the group to be included in the application are controlled by the insolvent parent; the assets of those members of the group cannot be separated; the affairs of the solvent group member are so intermingled with those of other group members that it would be beneficial for the solvent group member to be included in reorganization proceedings; or creditors have dealt with the group as a single unit.

(4) The insolvency law may permit a parent of a group of companies that meets the commencement standard of recommendation 15 of the Legislative Guide, to determine the other members of the group that should be included in a joint application for commencement of [insolvency] [reorganization] proceedings under recommendation (1).

*Debtor application: notice to creditors*

(5) The insolvency law should specify that, when joint insolvency proceedings commence against two or more members of a corporate group, notice of the commencement is to be given to all creditors of [members of the corporate group against which proceedings have commenced] [all members of the corporate group, including solvent members].

(6) The insolvency law should specify that the notice of insolvency proceedings is to include, in addition to the information specified in recommendation 25, information on the conduct of the joint administration of particular relevance to creditors.

*Creditor application: notice to the debtor*

(7) The insolvency law should specify that when an application is made by a creditor for commencement of insolvency proceedings against two or more members of a corporate group, notice of the application is to be given to all [members of the corporate group included in the application] [all members of the corporate group].

*Joint administration*

(8) The insolvency law may permit two or more [insolvency] [reorganization] proceedings pending [in the same court] against members of the same corporate group to be jointly administered.

***Notes on recommendations***

23. Recommendations (1)-(4) address the issue of joint applications for commencement of insolvency proceedings against two or more members of a corporate group.

24. Recommendation (1) is intended to address a joint application by all members of a corporate group that satisfy the commencement standard of recommendation 15 of the Legislative Guide.

25. Recommendation (2) is intended to address a joint application by a number of members of a corporate group, provided one of them satisfies the commencement standard of recommendation 15. This would allow solvent members to be included in the application for commencement, without specifying any conditions for that inclusion.

26. Recommendation (3) adopts a different approach, permitting an application made by certain members of a group to be extended to include other members, provided certain conditions are satisfied. The chapeau is drafted to reflect two alternatives: the first is an application by any member that satisfies the commencement standard of recommendation 15 that may be extended to any member that does not satisfy recommendation 15; the second is an application by a parent company satisfying the commencement standard that may be extended to include a subsidiary that does not satisfy that standard. The conditions include, in subparagraph (a), alternatives for extension by consent of relevant parties, including the group member to be included; all members of the group; creditors of the group member to be included; and all interested parties, which would include creditors (whether of the group member to be included or of all group members) and members of the group. Subparagraph (b) establishes conditions based upon control and integration.

27. Recommendation (4) permits the insolvent parent of a corporate group to determine which other members of the group should be included in an application for commencement of insolvency proceedings under recommendation (1).

28. Each of recommendations (1)-(4) includes an alternative with respect to the proceedings to be commenced: insolvency generally, as included in recommendation 15 of the Legislative Guide, or only reorganization, on the basis that these recommendations may be more appropriate to the reorganization of a corporate group.

29. Recommendations (5)-(7) address the provision of notice on application for commencement of proceedings in the case of a creditor application and on commencement in the case of a debtor application, closely following recommendations 19 and 22 of the Legislative Guide; those recommendations establish the difference in the time at which notice is to be given, depending upon whether the application for commencement is made by the debtor or a creditor.

30. Recommendation (8) addresses the possibility that, where insolvency proceedings have already commenced against two or more members of a group, they could be jointly administered.

## B. Treatment of assets on commencement of insolvency proceedings

[Reference: Legislative Guide: part two, chap. II, paras. 1-215, and recommendations 35-107; chap. III, paras. 35-74 and recommendations 115-125]

31. The ways in which the commencement of insolvency proceedings affect the debtor and its assets are discussed in detail in the Legislative Guide.[5] In general, those effects would apply equally to commencement of insolvency proceedings against two or more members of a corporate group. Some of the effects that might differ in the group context are discussed below, with respect to administration of the estates of group members; appointment of an insolvency representative; application of the stay; use and disposal of assets; post-commencement finance; avoidance; subordination; and remedies, including contribution and consolidation orders.

### 1. Joint administration and appointment of an insolvency representative

32. A joint application would give rise to joint administration (sometimes also referred to as procedural or administrative consolidation) of the estates of those group members included in the proceedings, but should not affect the substantive rights of each of those debtors or the liability of each member to its own creditors. To save time and costs, certain procedures may be able to be conducted jointly, for example meetings of creditors of two or more members of the group being administered. Consideration could be given to whether or not the consent of all affected creditors would be required. Voting would remain separate for each group member on issues relevant to that member.

33. Joint administration of the different estates would be facilitated by the appointment of a single insolvency representative. Such an appointment would ensure coordination of the administration of the various group members, reduce related costs and facilitate the gathering of information on the corporate group as a whole.

34. While many insolvency laws do not address this question, there are some jurisdictions where appointment of a single insolvency representative in the group context has become a practice. This has also been achieved to a limited extent in some cross-border insolvency cases (discussed further below).

35. Where a single insolvency representative is appointed to administer a group involving multiple debtors with complex financial and business relationships and

[5] UNCITRAL Legislative Guide, part two, chap. II.

different groups of creditors, conflict may arise, for example, with respect to cross-guarantees, intra-group debts or the wrongdoing by one group member with respect to another group member. As a safeguard against possible conflict, the insolvency representative could be required to give an undertaking or be subject to a practice rule or statutory obligation to seek direction from the court in the event a conflict arises. Additionally, the insolvency law could provide for the appointment of a further insolvency representative to administer the other debtor or debtors involved in the conflict. The obligation of disclosure contained in recommendations 116 and 117 of the Legislative Guide may be relevant to conflict situations arising in a group context.

36. If appointment of a single insolvency representative is not possible, or if more than one insolvency representative is required to be appointed because of an apparent conflict, an insolvency law could specify obligations additional to those applicable to insolvency representatives under the Legislative Guide (recommendations 111, 116-117, 120) to facilitate coordination of the different proceedings. These obligations might include: sharing and disclosure of information; cooperation on use and disposal of assets; proposal and negotiation of coordinated reorganization plans (unless preparation of a single group plan is possible as discussed below); coordination of use of avoidance powers; obtaining of post-commencement finance; and coordination of filing and admission of claims.

37. The insolvency law could also address timely resolution of disputes between the different insolvency representatives appointed. Consideration might be given to the question of whether, in a group context, where different insolvency representatives are appointed to administer the parent and different subsidiaries, the insolvency representative appointed to the parent should have any additional coordinating role with respect to the other insolvency representatives or additional powers to resolve disputes or conflicts.

***Recommendations***

*Appointment of a single insolvency representative*

(9) The insolvency law should specify that, where insolvency proceedings against two or more members of a corporate group are to be jointly administered, a single insolvency representative may be appointed to conduct that joint administration.

(10) The insolvency law should include measures to address a conflict of interest that might arise in a joint administration where only one insolvency representative is initially appointed. Such measures could include the appointment of an additional insolvency representative.

*Appointment of more than one insolvency representative*

(11) The insolvency law should specify that, where insolvency proceedings are commenced against two or more members of a corporate group and more than one insolvency representative is appointed, the insolvency representatives should cooperate to the maximum extent possible to facilitate coordination of the administration of the proceedings.

*Notes on recommendations*

38. Recommendation (9) permits a single insolvency representative to be appointed to a joint administration of insolvency proceedings against two or more members of a corporate group.

39. Recommendation (10), in addition to recommendations 116 and 117 of the Legislative Guide, addresses the issue of conflict that may arise in a joint administration and proposes one way in which that conflict might be addressed. Other possible means that could be included in the recommendation are referred to in the commentary, paragraph 35 above.

40. Recommendation (11) addresses the key importance of facilitating coordination of the proceedings where more than one insolvency representative is appointed in a joint administration. It uses the wording of articles 25 and 26 of the UNCITRAL Model Law on Cross-Border Insolvency: "cooperate to the maximum extent possible". What that cooperation might cover or how it might be achieved, as discussed in paragraph 36 of the commentary, could be included in the recommendation by way of example.

## 2. Application of the stay

41. The Legislative Guide notes[6] that many insolvency laws include a mechanism to protect the value of the insolvency estate that not only prevents creditors from commencing actions to enforce their rights through legal remedies during some or all of the period of insolvency proceedings, but also suspends actions already under way against the debtor. The provisions of the Legislative Guide relating to the application of that mechanism, referred to as a "stay", would apply generally in the case of insolvency proceedings against two or more members of a corporate group (see recommendations 39-51).

42. One issue that might arise in the context of the insolvency of corporate groups is the extension of the stay to a solvent member that is not subject to the insolvency proceedings (where the insolvency law permits a solvent member of a group to be included in the proceedings, as discussed above, this issue will not arise). Such an extension might be necessary, for example, to protect an intra-group guarantee that relies upon the assets of the solvent group member providing the guarantee. Such extension of the stay has the potential to affect the business of the solvent member and the interests of its creditors, depending upon the nature of the solvent member and its function within the group structure. The day-to-day activities of a trading group member, for example, may be more adversely affected than those of a subsidiary established to hold certain assets or obligations.

43. In some jurisdictions, ordering insolvency-related relief against a solvent member of a group (not included in insolvency proceedings) might not be possible as it might conflict, for example, with the protection of property rights or raises issues of constitutional rights. Nevertheless, it might be possible to achieve the same effect if a court could order provisional measures in conjunction with the commencement of insolvency proceedings against other members of that corporate group in certain cases, such as where there is an intra-group guarantee. The

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[6] UNCITRAL Legislative Guide, part two, chap. II, para. 26.

measures may be available at the courts' discretion, subject to such conditions as the court determines appropriate.

44. Such measures might be covered by recommendation 48 of the Legislative Guide, which provides for the court to grant relief in addition to any relief that might be applicable automatically on commencement of insolvency proceedings (such as that addressed in recommendation 46). As the footnote to recommendation 48 points out, that additional relief would depend upon the types of measures available in a particular jurisdiction and the measures that might be appropriate in a particular insolvency proceeding.

45. Protection for the interests of the creditors, both secured and unsecured, of the solvent member of the group, might be found in the relevant provisions of the Legislative Guide; recommendation 51 for example specifically addresses the issue of protection of secured creditors and grounds for relief from the stay applicable on commencement and might be extended to secured creditors of the solvent group member. Other grounds for relief from the stay might relate to the financial situation of the solvent member and the continuing effect of the stay on its day-to-day operations and, potentially, its solvency.

46. Where a secured creditor is another member of the same corporate group, a different approach to the question of protection might be required, especially where the insolvency law permits consolidation or subordination of related person claims (see below).

***Recommendations***

(12) The law should specify that, where insolvency proceedings have commenced against two or more members of a corporate group, the court may grant relief at the request of [a member of the corporate group] [the insolvency representative] where relief is needed to protect and preserve the value of the assets of a member of the corporate group not subject to the insolvency proceedings.

That relief may include:

(a) Staying the commencement or continuation of individual actions or proceedings concerning the assets, rights, obligations or liabilities of the member of the corporate group not subject to the insolvency proceedings;

(b) Staying execution or other enforcement against the assets of the member of the corporate group not subject to the insolvency proceedings;

(c) Suspending the right of a counterparty to terminate any contract with the member of the corporate group not subject to the insolvency proceedings; and

(d) Suspending the right to transfer, encumber or otherwise dispose of any assets of the member of the corporate group not subject to the insolvency proceedings.

***Notes on recommendations***

47. At its thirty-first session the Working Group agreed that the effects of a stay should not be automatically extended to solvent members of a group, but that there

would be certain cases where it could be extended at the discretion of the court and subject to certain conditions.[7]

48. Recommendation (12) is an outline of the types of measure that might apply in such circumstances, based upon recommendation 39 of the Legislative Guide. The Working Group may wish to consider the specific circumstances in which such relief might be appropriate and any conditions to which it might be subject.

49. The Working Group also noted[8] that recommendation 51 of the Legislative Guide, which addresses relief from measures applicable on commencement of insolvency proceedings, may have some application beyond secured creditors where the stay is ordered against a member of the group not subject to the insolvency proceedings. The Working Group may wish to consider, against the background of recommendation 51, grounds for relief from the stay referred to in recommendation (12) and their application to both secured and unsecured creditors.

### 3. Use and disposal of assets

50. The Legislative Guide notes[9] that, although as a general principle it is desirable that an insolvency law not interfere unduly with the ownership rights of third parties or the interests of secured creditors, the conduct of insolvency proceedings will often require assets of the insolvency estate, and assets in the possession of the debtor being used in the debtor's business, to continue to be used or disposed of (including by way of encumbrance) in order to enable the goal of the particular proceedings to be realized.

51. Where insolvency proceedings concern two or more members of a corporate group, issues may arise with regard to the use of assets belonging to a solvent member of the same group to support ongoing operations of the insolvent members pending resolution of the proceedings. Where those assets are in the possession of one of the insolvent group members, recommendation 54 of the Legislative Guide, which addresses the use of third party owned assets in the possession of the debtor, may be sufficient. Recommendation 54 provides:

> "*Use of third-party-owned assets*
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> *54. The insolvency law should specify that the insolvency representative may use an asset owned by a third party and in the possession of the debtor provided specified conditions are satisfied, including:*
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> *(a) The interests of the third party will be protected against diminution in the value of the asset; and*
>
> *(b) The costs under the contract of continued performance of the contract and use of the asset will be paid as an administrative expense*."

52. Where those assets are not in the possession of any of the insolvent group members, recommendation 54 generally will not apply. There may be circumstances, however, where the solvent group member is included in the

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[7] Report of Working Group V (Insolvency Law) on the work of its thirty-first session, A/CN.9/618, para. 31.

[8] Ibid., para. 30.

[9] UNCITRAL Legislative Guide, part two, chap. II, para. 74.

insolvency proceedings and the provisions of a group reorganization plan would cover the assets. Where the solvent group member is not included in the proceedings, the question will be whether those assets can be used to support the insolvent group members and if so, the conditions to which that use would be subject. The use of those assets might raise questions of avoidance, particularly where the supporting member subsequently became insolvent, and also raises concerns for creditors of the solvent member.

53. The Working Group may wish to consider the circumstances in which assets of a solvent group member could be used to support the reorganization of insolvent members of the same group, where that solvent member is not subject to the insolvency proceedings.

### 4. Post-commencement finance

54. The Legislative Guide[10] recognizes that the continued operation of the debtor's business after the commencement of insolvency proceedings is critical to reorganization and, to a lesser extent, liquidation where the business is to be sold as a going concern. To maintain its business activities, the debtor must have access to funds to enable it to continue to pay for crucial supplies of goods and services, including labour costs, insurance, rent, maintenance of contracts and other operating expenses, as well as costs associated with maintaining the value of assets. The Guide notes, however, that many jurisdictions restrict the provision of new money in insolvency or do not specifically address the issue of new finance or the priority for its repayment in insolvency. Very few, if any, of those laws specifically address the issue in the context of corporate groups.

55. The Legislative Guide includes recommendations 63-68, which aim to promote the availability of finance for continued operation or survival of the debtor's business and provide appropriate protection for the providers of post-commencement finance, as well as appropriate protection for those parties whose rights may be affected by the provision of post-commencement finance.

56. While post-commencement finance is important in the context of individual proceedings, as noted in the Legislative Guide, it is even more critical in the group context; if there are no ongoing funds there is very little prospect of reorganizing an insolvent group. One of the questions with respect to post-commencement finance in the corporate group context is whether the assets of a solvent member of a group can be used to obtain financing for an insolvent member from an external source or to fund the insolvent member directly and, if so, what are the implications for the recommendations of the Legislative Guide concerning priority and security. For example, would a solvent subsidiary be entitled to priority under recommendation 64 if it provided funding to its insolvent parent or would that transaction be subject to subordination as intra-group lending? Using group assets to obtain financing may generally be possible where all members of the group are subject to insolvency proceedings; this would be covered by the recommendations of the Legislative Guide. Difficulties are likely to arise, however, where it is proposed that the assets of a solvent member be used to fund an insolvent member or as the basis for obtaining external funding. In general, as noted above, it is not

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[10] UNCITRAL Legislative Guide, part two, chap. II, section D, para. 94, Purpose of legislative provisions preceding recommendation 63.

likely to be permitted by insolvency law, although there might be situations where funding could be provided if the creditors of the solvent member consented.

57. In addition to the recommendations included below, recommendation 68 of the Legislative Guide will be relevant where reorganization proceedings are converted to liquidation.

***Recommendations***

*Attracting and authorizing post-commencement finance for a corporate group*

(13) The insolvency law should specify that a corporate group or any member of a corporate group can obtain post-commencement financing under the circumstances and standards set forth in recommendations 15-18, below.

(14) The insolvency law should facilitate and provide incentives for post-commencement finance to be obtained by [the insolvency representative of a corporate group] [an insolvency representative of any member of a corporate group] where the insolvency representative determines it to be necessary for the continued operation or survival of the business of the [corporate group [or any of its members]], or the preservation or enhancement of the value of the estates of one or more members of the group. The insolvency law may require the court to authorize, or the creditors of any affected member of the group to consent to the provision of post-commencement finance for the group [or any member of the group], as specified in recommendation 18 and 19, below.

*Guarantee or other assurances for repayment of post-commencement finance for a corporate group*

(15) The insolvency law should specify that a member of a [corporate group [that is a debtor]] may guarantee or provide other assurance of repayment for post-commencement finance obtained by another member of the corporate group so long as the court determines that:

(a) [The estate of] the debtor-guarantor would receive benefits from such post-commencement finance comparable to those received by the obtainer of post-commencement finance; or

(b) The [creditors] [insolvency representative] of the debtor-guarantor consent to the provision of that guarantee or other assurance of repayment; or

(c) The creditors of the debtor-guarantor would suffer no economic harm as a result of such guarantee or other assurance of repayment.

*Priority for post-commencement finance for a corporate group*

(16) The insolvency law should establish the priority that may be accorded to post-commencement finance provided to [a corporate group] [or member of a corporate group], ensuring at least the payment of the post-commencement finance provider ahead of the ordinary unsecured creditors of each member of the group, including those unsecured creditors with administrative priority.

*Security for post-commencement finance for a corporate group*

(17) The insolvency law should enable a member of a corporate group to grant a security interest for repayment of post-commencement finance provided to the group [or member of the group], including a security interest on an unencumbered asset, including an after-acquired asset, or a junior or lower priority security interest on an already encumbered asset of the estate of such member of the group.

(18) The law[11] should specify that a security interest over the assets of the estate of any member of the corporate group granted to secure post-commencement finance for [any other member of] the group does not have priority ahead of any existing security interest over the same assets unless the insolvency representative [of each affected member of the group] obtains the agreement of existing secured creditor(s) or follows the procedure in recommendation 19.

(19) The insolvency law should specify that, where any existing secured creditor does not agree [that post-commencement finance should be accorded a priority senior to its security interest], the court may authorize the creation of a security interest having priority over pre-existing security interests provided specified conditions are satisfied, including:

(a) The existing secured creditor was given the opportunity to be heard by the court;

(b) It can be proven that the corporate group cannot obtain the finance [in any other way] [on more favourable terms and conditions]; and

(c) The interests of the existing secured creditor will be protected.

***Notes on recommendations***

58. With the exception of recommendation (15), these recommendations are based upon recommendations 63-67 of the Legislative Guide.

59. To some extent, recommendations (13) and (14) overlap. Recommendation (13) specifically requires the insolvency law to include provisions enabling post-commencement finance and specifying the applicable circumstances and conditions. Recommendation (14) is based on recommendation 63 of the Legislative Guide and is of general application, focussing upon the desirability of providing incentives for post-commencement finance and addressing the question of consent; it does not explicitly refer to the need for statutory provisions on post-commencement finance.

60. Recommendation (15) addresses the situation where post-commencement finance may be obtained by one member of a group for use by another member and permits the first member to guarantee its repayment, provided certain conditions are met. By including the phrase "[that is a debtor]", it leaves open the question of whether the member of the group providing the guarantee could be a group member not subject to the insolvency proceedings.

61. As drafted, these recommendations leave open issues of (i) the consolidated administration of the estates of the members of a corporate group; (ii) appointment

[11] This rule may be in a law other than the insolvency law, in which case the insolvency law should note the existence of the provision.

of one insolvency representative for the corporate group as a whole; and (iii) inclusion of a solvent member of a corporate group in insolvency proceedings related to the other, insolvent, members of the group.

[*The continuation of* III. The onset of insolvency: domestic issues *is contained in A/CN.9/WP.76/Add.1;* IV. International issues *is contained in A/CN.9/WP.76/Add.2.*]