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Treatment of corporate groups in insolvency

Note by the Secretariat

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IV. International issues

A. Introduction

1. The Working Group may wish to consider whether the background material contained in paragraphs 1-4 of document A/CN.9/WG.V/WP.74/Add.2 could form the basis of an introduction to this chapter on international issues.

B. Jurisdiction to commence insolvency proceedings: Centre of main interests (COMI)

2. The UNCITRAL Legislative Guide notes[1] that a debtor must have a sufficient connection to a State to be subject to its insolvency laws. In many cases, no issue as to the applicability of the insolvency law will arise as the debtor will be a national or resident of the State and will conduct its economic activities in the State through a legal structure registered or incorporated in the State. However, where there is a question of the debtor's connection with a State, insolvency laws adopt different tests, including whether the debtor has its centre of main interests in the State, whether the debtor has an establishment in the State or whether it has assets in the State.

3. Although both the European Council (EC) Regulation No. 1346/2000 of 29 May 2000 on insolvency proceedings (the EC Regulation) and the UNCITRAL Model Law on Cross-Border Insolvency (the Model Law) use the concept of COMI, with respect to commencement of proceedings in the case of the Regulation and the provision of assistance in the case of the Model Law, it is not defined in either text. Both, however, provide a presumption that a debtor's COMI is the registered office, or habitual residence in the case of an individual, unless it can be shown that it is elsewhere.

4. Although applicable to countries subject to the EC Regulation or that have adopted the Model Law, the concept of COMI is not universal and where it is used, is a developing concept. Moreover, neither the Regulation nor the Model Law specifically address the concept of COMI as it might apply to a corporate group, although a number of cases have considered issues such as the integration of companies in a group in the context of considering whether the presumption that the debtor's COMI is its registered office can be displaced in a given case.

5. actors identified as relevant to the rebuttal of the presumption, have included: the extent of a subsidiary's independence with respect to financial, management and policy decision-making; financial arrangements between parent and subsidiary, including capitalization, location of bank accounts and accountancy services; the division of responsibility with respect to provision of technical and legal documentation and signature of contracts; the location where design, marketing, pricing, delivery of products and office functions were conducted.

6. If the test of COMI were to be adopted universally, in practice, the COMI of each member of a corporate group, based on the treatment of individual members as

[1] UNCITRAL Legislative Guide, part two, chap. I, para. 12.

separate legal entities, could be located in a different jurisdiction, leading to insolvency proceedings being commenced in each of those jurisdictions. In that scenario, coordination and cooperation between the different proceedings would be essential to ensure a successful resolution of the groups' insolvency.

7. Achieving a coordinated result for the insolvency of one or more members of a corporate group located in different States depends upon whether the different proceedings against each member can be recognized in other jurisdictions and whether parties involved in the various proceedings can cooperate and coordinate with each other. In those States that have adopted the UNCITRAL Model Law on Cross-Border Insolvency,[2] the answer should be relatively straightforward; proceedings commenced where the debtor has its COMI could be recognized as foreign main proceedings, while proceedings commenced where the debtor has an establishment could be recognized as non-main proceedings and the effects of recognition provided by the Model Law would apply.[3] Where the Model Law has not been adopted, however, reference must be had to national laws, many of which do not contain provisions equivalent to those provided in the Model Law with respect to recognition, assistance, cooperation or coordination.[4] Because of the absence of such provisions, achieving a coordinated result can be time-consuming, costly and, in some cases, impossible.

8. For those reasons, coordination of international insolvency proceedings has been greatly facilitated in recent years by practices and procedures developed by insolvency professionals and courts, starting with individual cases and the need to address particular issues faced by the parties. Agreements or "protocols" have been negotiated by the parties and approved by the courts in the jurisdictions involved. Those cross-border insolvency protocols cover a number of issues, including, for example, settling a particular dispute arising from the different laws in concurrent cross-border proceedings, creating a legal framework for the general conduct of the case and coordinating the administration of an insolvent estate in one State with an administration in another State.

9. The Working Group may wish to note the progress with work being undertaken by the UNCITRAL secretariat through informal consultations with judges and insolvency practitioners to compile practical experience with respect to negotiating and using cross-border insolvency protocols.[5] A report is being prepared on the development of that work (A/CN.9/629) for consideration by the fortieth Commission in 2007.

10. As an alternative to multiple proceedings, it might be possible in some cases to bring together insolvency proceedings against different group members. The insolvency proceedings might be conducted in or coordinated from a single

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[2] Adopted in British Virgin Islands, overseas territory of the United Kingdom of Great Britain and Northern Ireland (2005), Eritrea, Great Britain (2006), Japan (2000), Mexico (2000), Montenegro (2002), Poland (2003), Romania (2003), Serbia (2004), South Africa (2000) and United States of America (2005).

[3] See UNCITRAL Model Law on Cross-Border Insolvency: art. 17 on decision to recognize and arts. 20 and 21 on effects of recognition.

[4] For an analysis of the law of 39 jurisdictions, see "Cross-Border Insolvency: A Guide to Recognition and Enforcement", INSOL International, 2003.

[5] See *Official Records of the General Assembly, Sixty-first session, Supplement No. 17* (A/61/17), para. 209 for the decision of the Commission to undertake this work.

jurisdiction or some form of joint administration might be possible (see below). Identifying the jurisdiction most central for a corporate group might be assisted by developing a concept of a "corporate group COMI"; or developing a rule deeming the COMI of the group to be, for example, the place of registration of the parent of the group or the place where it conducts its business activities. The extent to which those approaches could be achieved would depend upon widespread acceptance of a single standard or rule and agreement on what might constitute a "corporate group" for the purposes of such a rule.

11. Establishing the concept of COMI for a corporate group would be of particular relevance in cases where there was a high degree of integration between members of a corporate group and the group was run essentially as a single entity, with the activities of the group centralized at the COMI. The concept could be defined by reference to, for example, the issues discussed in para. 5 above, such as how and where policy, management and financial decisions of the group were made and third party perceptions, particular those of creditors, concerning that location. The COMI would determine the jurisdiction in which insolvency proceedings against a corporate group could be commenced and the law that would apply to commencement and administration of the proceedings.

12. Where the adoption of such an approach depended on close integration of the group, the requisite level of integration would need to be defined. Creditors would be required to investigate the connections of a company with which they dealt to ascertain whether or not it was part of a group. Such an approach may lead to a disconnection between the place of business of a member of a corporate group and the place in which insolvency proceedings could be commenced against that member. Additional proceedings might still be required in the jurisdiction away from the COMI in which group members conducted their businesses and held their assets.

13. Where such an approach relied upon a consideration of different factors to determine the COMI of the group it would not always be possible to ascertain that location before the insolvency proceedings actually commenced. A rule deeming the COMI to be in a specific location would create more certainty. A further issue would arise however with respect to widespread recognition and enforcement of such a rule and the decisions made in pursuance of it. Even if one court took the view that the COMI of the corporate group fell under its jurisdiction and it could therefore hear applications with respect to other members of that group, other courts would not necessarily concur with that decision in the absence of a binding obligation to do so. This could lead to competing and overlapping claims. In addition, different views might be taken with respect to the inclusion of an enterprise in a corporate group, particularly an international corporate group; for example, some courts might regard as a subsidiary what others might regard as a domestic company, notwithstanding its connection to members of a group located elsewhere. A further consideration would be the extent to which the determination that the COMI of a number of group members was found to be in one jurisdiction, would disadvantage creditors, including employees, who were located in jurisdictions different to that of the COMI, with respect, for example to filing claims, participating in creditor committees and participating at hearings.

14. A further approach, as noted above, could be to deem the COMI of the group to be that of the parent of a corporate group, so that all other group members would

also have that COMI and jurisdiction for commencement of proceedings would not be related to place of incorporation or registered office, except as it related to the parent where that was a determinant of COMI. Difficulties might arise, however, where the parent was not insolvent but group members located elsewhere were insolvent.

15. Applicable on a regional basis, the *Transnational Insolvency: Principles of Cooperation among NAFTA Countries*[6] recommend two rules concerning subsidiaries in the context of corporate groups. The first[7] is that a subsidiary should be permitted to apply for insolvency in the jurisdiction in which the parent's insolvency proceedings have commenced so that reorganization can be administered on a group basis. The possibility of parallel proceedings is acknowledged, in which case coordination should facilitate achievement of the benefits of consolidation as far as possible. The second recommendation[8] is that corporate groups should be reorganized from a global perspective, subject to the necessity of allocating value with regard to the corporate form. The principles provide an exception for those situations where either the main jurisdiction or the subsidiary's jurisdiction require insolvency as a condition of making an application for commencement of proceedings or the court of the main proceeding will not ordinarily accept jurisdiction over a company that is not registered and does not do business in that country, which will often be true of the subsidiary.

16. At its thirty-first session,[9] the Working Group acknowledged that the difficulties in achieving an agreed definition of the concept of COMI suggested the need to focus on facilitating coordination and cooperation between the various courts in which insolvency proceedings against different members of a corporate group might be commenced, while acknowledging the desirability of avoiding a multiplicity of proceedings in the corporate group context.

17. The Working Group may wish to consider the issue of commencement of insolvency proceedings in the group context further in light of the discussion outlined above and the discussion of joint administration and reorganization below. The Working Group might wish to consider, for example, the possibility of supplementing the provisions of the UNCITRAL Model Law on Cross-Border Insolvency to specifically address coordination and cooperation in the context of corporate groups. Those provisions might include, for example, facilitation of joint administration and approval of unified reorganization plans.

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[6] Developed by The American Law Institute, 2003 as part of its Transnational Insolvency project, available at www.ali.org.

[7] Procedural Principle 23: Coordination with Subsidiaries.
It should be permissible to file bankruptcy for a subsidiary in the same jurisdiction as the parent's bankruptcy, and to have either procedural or substantive consolidation under applicable law, absent a proceeding involving the subsidiary in the country of its main interests. Where the subsidiary is in a parallel proceeding in the country of its main interests, coordination between the two proceedings should achieve the benefits of consolidation where possible.

[8] Procedural Principle 24: Principles as Applied to Subsidiaries
The principles of coordination and cooperation should include parallel proceedings involving a subsidiary of a foreign parent debtor to the same extent as with parallel proceedings involving the debtor, although certain decisions, such as allocation of value, may be differently determined because of the need to honour the corporate form.

[9] Report of Working Group V (Insolvency Law) on the work of its thirty-first session, A/CN.9/618, para. 54.

C. Treatment of assets on commencement of insolvency proceedings

1. Joint administration

18. As noted above with respect to the domestic context,[10] joint administration has the potential to facilitate the conduct of insolvency proceedings by reducing costs and delays. It also has this potential in the cross-border context. However, while in the domestic context there might be procedures that would enable proceedings commenced in different jurisdictions to be brought together, those procedures generally do not exist at the international level, although a practice of facilitating joint administration does exist between some neighbouring jurisdictions.[11] At the international level, proceedings in different jurisdictions involve diversity of assets, creditors, laws, and priorities, as well as questions concerning choice of the jurisdiction from which joint administration should be conducted, the treatment that might be applicable to solvent members in different jurisdictions and the ability of the insolvency representatives to operate in different jurisdictions, particularly those in which they are not qualified under the relevant law.

19. In some situations there might be a need for parallel proceedings to address some of these issues, although in general a multiplicity of proceedings should be avoided in order to facilitate coordination and cooperation. Joint administration, which does not require a formal decision with respect to a group's centre of main interests, would be facilitated by adoption of the UNCITRAL Model Law, to provide a legislative framework for cross-border cooperation and communication, and the use of cross-border protocols or other mechanisms to address procedural and administrative issues arising between the different jurisdictions.

2. Post-commencement finance

20. The Working Group may wish to consider whether paragraphs 15-22 of A/CN.9/WG.V/WP.74/Add.2 could be revised to form the commentary for this section on post-commencement finance.

Recommendations

Attracting and authorizing post-commencement finance for an international corporate group

(24) The insolvency law should enable an international corporate group [or any member of the group] to obtain post-commencement finance under the circumstances and standards set forth in recommendations 26 to 32, below.

(25) The insolvency law should facilitate and provide incentives for post-commencement finance to be obtained by the insolvency representative of any member of an international corporate group where the insolvency representative determines it to be necessary for the continued operation or survival of the business of the international 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 either the court with jurisdiction over any affected member of the group to authorize, or the creditors of any affected member of the

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[10] A/CN.9/Working Group.V/WP.76, paras. 32-37.

[11] For example, Canada and the USA.

group, to consent to the provision of post-commencement finance to such affected member of the group, as specified in recommendations 31 and 32, below.

(26) The insolvency law should permit a debtor that is a member of an international corporate group to receive the proceeds of post-commencement finance obtained by another member or members of such group.

Guarantee or other assurances for repayment of post-commencement finance for an international corporate group

(27) The insolvency law should specify that a member of an international corporate group [that is a debtor] may guarantee or provide other assurance of repayment for post-commencement finance obtained by another member of the international corporate group provided the court with jurisdiction over the debtor-guarantor 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 the 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 an international corporate group

(28) The insolvency law should establish the priority that may be accorded to post-commencement finance provided to a member of an international corporate group, provided the court with jurisdiction over that member ensures at least the payment of the post-commencement finance provider ahead of the ordinary unsecured creditors of that member, including those unsecured creditors with administrative priority.

Security for post-commencement finance for an international corporate group

(29) The insolvency law should enable a member of an international corporate group to grant a security interest for repayment of post-commencement finance provided to that 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 that member of the group.

(30) The insolvency law should enable a member of an international corporate group to grant a security interest for repayment of post-commencement finance provided to another 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 such grantor.

(31) The law should[12] specify that a security interest over the assets of the estate of any member of an international corporate group granted to secure

[12] This rule may in a law other than the insolvency law, in which case the insolvency law should

post-commencement finance for any member(s) 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 32.

(32) 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 with jurisdiction over the member of the group that is subject to the existing security interest 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 affected member(s) of the international 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

21. These recommendations are based upon recommendations 63 to 67 of the Legislative Guide and recommendations 13 to 19 of A/CN.9/WG.V/WP.76 with respect to post-commencement finance for a corporate group in a domestic context.

22. The notes in paragraphs 58 to 61 of A/CN.9/WG.V/WP.76 with respect to draft recommendations 13 to 19 would apply also to these draft recommendations.

23. Recommendation 26 permits one member of a corporate group to receive post-commencement finance obtained by another member of the same group, where those members might be in different jurisdictions and finance could not be provided in that situation without specific legislative authorization.

24. Recommendations 29 and 30 are based on recommendation 17, but deal respectively with a security interest provided by the group member receiving the finance and by a group member other than the group member receiving the finance, where those members may be located in different jurisdictions.

25. As noted above with respect to post-commencement finance in a domestic context, recommendation 68 of the Legislative Guide, which seeks to preserve the priority afforded to post-commencement finance, would be relevant where reorganization proceedings against a member or members of a corporate group are converted to liquidation.

D. Remedies: Substantive consolidation

26. As discussed in the domestic context,[13] where a group is closely integrated and assets and liabilities belonging to each group member cannot be easily identified, cross-border substantive consolidation might facilitate the administration

note the existence of the provision.

[13] A/CN.9/WG.V/WP.76/Add.1, paras. 23-39.

of group proceedings. Consideration of this remedy in a cross-border case is, however, much more complex than in a domestic setting, since it raises issues relating to: applicable insolvency law; the extent to which courts could waive rules in a cross-border situation that would be applied in a domestic case; applicable avoidance rules; negotiation, approval and implementation of a single reorganization plan; applicable rules on recognition of claims and distribution; treatment of security interests; and so forth.

27. Consolidation in cross border cases is not common. There are, however, examples of cases where the insolvency of a closely integrated group involving subsidiaries in different jurisdictions has been administered as if it were a single entity with the consent of creditors, as well as examples involving a unified reorganization plan.

E. Reorganization: Unified reorganization plans

28. As noted above in the domestic context,[14] the ability to negotiate a single reorganization plan has the potential to facilitate reorganization of a corporate group in several ways. This is also true in the international context, although different considerations will apply, including how different requirements with respect to proposal and approval of a reorganization plan in different jurisdictions could be satisfied in the case of a single plan and whether a reorganization plan approved in one jurisdiction could be recognized or regarded as binding in another.

29. A unified reorganization plan might be possible in those cases where the laws concerning negotiation and approval of a plan in the relevant jurisdictions are not significantly different or where the differences between those laws can be resolved by way of a protocol. One approach, at a regional level, is proposed by *The Principles of Cooperation among NAFTA Countries*,[15] which address the possibility of making a reorganization plan approved in a main proceeding binding in non-main proceedings, provided certain safeguards are met.

> "Recommendation 5: Binding Effect of Plans
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> The NAFTA countries should adopt provisions requiring approval of main-proceeding reorganization plans by courts in non-main proceedings despite a lack of compliance with rules for approval of such plans under domestic law if (a) the plan distribution will include significant value from assets or operations from outside the approving country; (b) the plan has been approved under the voting requirements of the law of the main proceeding; (c) creditors and other interested parties from the approving country have had a fair and reasonable opportunity to participate in the main proceeding; and (d) the plan does not discriminate unfairly on the basis of national citizenship, residence, or domicile. The provisions should also make such a plan final and binding in the approving country on the rights of all parties interested in the debtor's affairs to the same extent as it is under the law of the main proceeding."

30. Where there is only a main proceeding, and no parallel proceedings within NAFTA, the Principles provide, firstly, that the plan should be final and binding

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[14] A/CN.9/WG.V/WP.76/Add.1, paras. 40-43.

[15] See note 6 above and also paragraph 15 above.

upon the debtor and upon every creditor who participates in any way in the main proceeding. For this purpose, participation includes filing a claim; voting; or accepting a distribution of money or property under a plan.[16] The Principles provide further that the plan should also be final and binding as to the claims against the debtor of every unsecured creditor who was given adequate individual notice of the case; and who would be considered within the jurisdiction of the courts in ordinary commercial matters under the law of the country of the main proceeding, with respect to the type of claims asserted by that creditor.[17]

31. The operation of those Principles would mean that every creditor that participated in the specified manner in the main proceedings could be bound by the plan approved in those proceedings even if they did not support the plan, as could any creditor that was notified of the proceedings and had sufficient contacts with the country of the main proceeding to make the operation of its insolvency jurisdiction over that creditor reasonable.

32. The Working Group may wish to consider how the proposal and approval of a unified reorganization plan might be facilitated, in addition to draft recommendations 22 and 23 which apply in a domestic context, in a cross-border insolvency context.

F. Other issues: Conflicts of laws

33. The Working Group may wish to recall the discussion of conflict of laws issues in the context of the Legislative Guide[18] and consider the extent to which conflict of laws issues as they relate to the insolvency of international corporate groups could be addressed in future work on corporate groups.

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[16] Procedural Principle 26: Plan Binding on Participant.

[17] Procedural Principle 27: Plan Binding: Personal Jurisdiction.

[18] UNCITRAL Legislative Guide, part two, chap. I, paras. 80-91 and recommendations 30-34.