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Treatment of enterprise groups in insolvency

Note by the Secretariat

I. Introduction

1. This note draws upon the material contained in documents A/CN.9/WG.V/WP.74 and Add.1 and 2; A/CN.9/WG.V/WP.76 and Add.1 and 2; A/CN.9/WG.V/WP.78 and Add.1; the UNCITRAL Legislative Guide on Insolvency Law (the Legislative Guide); the UNCITRAL Model Law on Cross-Border Insolvency (the Model Law); and the Reports of Working Group V (Insolvency Law) on the work of its thirty-first, thirty-second and thirty-third sessions (A/CN.9/618, A/CN.9/622 and A/CN.9/643 respectively). It includes a revision of the recommendations discussed at the thirty-third session of the Working Group (Vienna, 5-9 November 2007), together with notes explaining the revisions and raising additional questions for the consideration of the Working Group.

2. Recommendations bear two numbers: the new number is in parentheses; the previous number from A/.CN.9/WG.V/WP.78 and Add.1 is in square brackets.

3. As explained in the Notes on Recommendations, purpose clauses have been introduced with respect to those topics not previously addressed in the Legislative Guide (for example, joint application, procedural coordination and substantive consolidation). The purpose clauses from the Legislative Guide would continue to be relevant with respect to recommendations on other topics (for example, avoidance proceedings) and have not been repeated in this note.

4. It is proposed that the commentary (the material appearing as General Remarks in A/CN.9/WG.V/WP.78 and addenda and as introductory material in documents A/CN.9/WG.V/WP.76 and addenda and A/CN.9/WG.V/WP.74 and

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addenda) be revised and consolidated for consideration by the Working Group at its thirty-fifth session in 2008. The Working Group may wish to consider that proposal.

II. Glossary

A. Terms and explanations

(a) "Enterprise group": two or more enterprises, which may include enterprises that are not incorporated, that are bound together by means of capital or control.

(b) "Enterprise": any entity, regardless of its legal form, engaged in economic activities, including entities engaged on an individual or family basis, as a partnership or an association.[1]

(c) "Capital": contributions to an enterprise, including assets and equity interests.[2]

(d) "Control": the power normally associated with the holding of a strategic position within the enterprise group that enables its possessor to dominate directly or indirectly those organs entrusted with decision-making authority; slight control or influence is not sufficient. Control could also exist pursuant to a contractual arrangement that provides for the requisite degree of domination.

(e) "Procedural coordination": coordination of the administration of [separate][individual] insolvency proceedings in respect of two or more members of an enterprise group. Each member, including its assets and liabilities, remains separate and distinct, thus preserving the integrity of the individual enterprises.[3]

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[1] Consistent with the approach adopted in the UNCITRAL Legislative Guide on Insolvency Law, the focus is upon the conduct of economic activities by entities that would conform to the types of entities described as an "enterprise". It is not intended to include consumers or other entities that would not be governed by an insolvency law pursuant to recommendations 8 and 9 of the Legislative Guide.

[2] Equity interests would include both trust units and partnership interests.

[3] [*taken from A/CN.9/WG.V/WP.78, para. 2 (f), page 3*] Procedural coordination is intended to promote procedural convenience and cost efficiency and may facilitate comprehensive information being obtained on the business operations of the group members subject to the insolvency proceedings; facilitate the valuation of assets and the identification of creditors and others with legally recognized interests; and avoid duplication of effort. Procedural coordination may include some or all of the following: cooperation between one or more courts, or in the domestic context, administration of the proceedings concerning group members in a single court; the appointment of a single insolvency representative to administer the insolvency proceedings or coordination between insolvency representatives where two or more are appointed; combined hearings and meetings, including joint meetings of creditors; joint deadlines; a single list for the provision of notices and coordinated provision of notice; a joint claims procedure; coordinated sale of assets; and a single creditor committee or coordination among creditors' committees.

(f) Substantive consolidation: [the pooling of the assets and liabilities of two or more members of an enterprise group to create a single insolvency estate for the benefit of creditors of the substantively consolidated members.][4]

(g) "Parent enterprise": an enterprise that directly or indirectly controls management and operations of another enterprise by influencing or electing its board of directors. The term may signify an enterprise that does not produce goods or services itself, but was formed for the purpose of owning shares of other enterprises (or owning other enterprises outright). [*from A/CN.9/WG.V/WP.74, para. 1 (c)*]

(h) "Subsidiary enterprise": an enterprise that is owned or controlled by another enterprise belonging to the same enterprise group. Usually, a subsidiary is incorporated under the laws of the State in which it is established. [*from A/CN.9/WG.V/WP.74, para. 1 (d)*]

B. Notes on terms

Enterprise group

1. At its thirty-third session, the Working Group agreed that the term to be explained should be "enterprise group", without any limitation to a domestic context or to one of business or commercial activity. International aspects of an enterprise group, such as application of the legislation of different States or conduct of business activities in different States, might require additional explanation at a future stage.[5]

Enterprise

2. At the thirty-third session of the Working Group, it was noted that the explanation of enterprise would include entities such as trusts, which could be part of an enterprise group under the law of certain States. The substance of the explanation was approved by the Working Group with the addition of a footnote to explain the exclusion of consumers and the limitation to entities that would be governed by an insolvency law pursuant to recommendations 8 and 9 of the Legislative Guide.[6] That limitation was previously included in the explanation of the term "*member of an enterprise group*",[7] which has now been deleted on the basis that it is unnecessary.

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[4] Substantive consolidation generally results in the extinguishment of intra-group liabilities and any issues concerning ownership of assets among the consolidated entities, as well as guarantee claims against any consolidated entity that guaranteed the obligations of another consolidated entity. A single insolvency representative is typically appointed, although that may depend on the stage in the proceedings at which the order is made.

[5] Report of Working Group V (Insolvency Law) on the work of its thirty-third session, A/CN.9/643, para. 123.

[6] Ibid., para. 124.

[7] See A/CN.9/WG.V/WP.78, paras. 2 (e) and 8.

Capital

3. At its thirty-third session, the Working Group agreed that "partnership interests" and "trust units" should be added to the list of what might constitute capital in an enterprise context. To further refine those concepts, the explanation has been revised to refer to equity interests, which is intended to cover both partnership interests and trust units. This is clarified by the footnote. The word "investment", which creates confusion in some languages, has been changed to the more generic "contribution". Equity interests would include shares, partnership interests and trust units, while assets would include cash and receivables.

4. The Working Group may wish to consider whether the suggestion made at the thirty-third session to draw a distinction between incorporated and unincorporated entities should be pursued in this explanation. [8]

Control

5. At its thirty-third session, the Working Group agreed that several issues with respect to the explanation of "control" required further consideration, including whether control should be limited to contractual arrangements; whether distribution and franchising agreements would be included; whether implied control should be excluded; and whether it was intended that certain types of secured transactions that might place a secured creditor in a position of control should be included.[9] The Working Group may also wish to consider whether the phrase "slight control or influence is not sufficient" is required in the explanation.

Member of an enterprise group

6. This term has been deleted and the reference to entities subject to the insolvency law is now included in the term "enterprise".

Procedural coordination

7. The explanation has been revised in accordance with the deliberations of the Working Group at its thirty-third session. [10] The footnote makes it clear that procedural coordination involves coordination between courts as well as insolvency representatives.

Substantive consolidation

8. The explanation of "substantive consolidation" is based upon the explanation included in the glossary, paragraph 1 (j)(ii), of document A/CN.9/WG.V/WP.74. It adopts the structure of the explanation of procedural coordination and includes a footnote setting forth the consequences of such an order.

Parent enterprise and subsidiary enterprise

9. These additional terms have been taken from document A/CN.9/WG.V/WP.74 and revised to align them with the other terms of the glossary.

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[8] A/CN.9/643, para. 125.
[9] Ibid., see paras. 13 and 126.
[10] Ibid., para. 128.

III. The onset of insolvency: domestic issues

A. Application and commencement: joint applications

1. Purpose of legislative provisions

[The purpose of provisions on joint application for commencement of insolvency proceedings is:

(a) To facilitate coordinated consideration of applications for commencement of insolvency proceedings concerning two or more members of an enterprise group; and

(b) To facilitate efficiency and reduce the costs associated with commencement of insolvency proceedings.]

2. Contents of legislative provisions

Joint application for commencement of insolvency proceedings

(1) The insolvency law may specify that an application for commencement of insolvency proceedings may be made with respect to a single debtor within the meaning of the Legislative Guide or a joint application for commencement of insolvency proceedings may be made with respect to two or more members of an enterprise group. Such a joint application may be made by:

(a) Two or more members of an enterprise group, provided that each of those members satisfies the commencement standard in recommendation 15 of the Legislative Guide; or

(b) A creditor of two or more members of an enterprise group provided that each of those members satisfies the commencement standard in recommendation 16 of the Legislative Guide.

3. Notes on recommendations

10. To better explain the purpose of the draft recommendations on joint application for commencement, an aspect of application and commencement not addressed in the Legislative Guide, the approach of the Legislative Guide has been adopted and a purpose clause introduced. The Working Group may wish to consider the purposes to be included in this clause.

11. Draft recommendation (1) provides that an application for commencement of insolvency proceedings with respect to two or more members of an enterprise group may be made individually for each member (in accordance with the recommendations of the Legislative Guide) or by way of a joint application covering a number of members. Where individual applications are made in accordance with the provisions of the Legislative Guide, those applications may be made at the same time and indicate a shared purpose, i.e. coordinated consideration of applications for commencement of proceedings with respect to a number of members of a group. The Working Group may wish to consider whether a sentence to that effect could usefully be added to the draft recommendation, or whether it would be sufficient for an explanation to be included in the commentary.

12. The revised recommendation adopts a permissive approach to the content of the insolvency law (the insolvency law "may" specify) and the broad approach of the Legislative Guide with respect to the types of proceedings that might be covered by a joint application, referring to commencement of "insolvency" proceedings, rather than "reorganization" proceedings.

13. Paragraph (a) clarifies that each member of the group that is the subject of a joint application must satisfy the relevant commencement standard. That standard includes, pursuant to recommendation 15 (a), imminent insolvency in the case of a debtor application. The Working Group noted at its thirty-third session that additional considerations might arise with respect to imminent insolvency in the group context and that these should be discussed in the commentary.[11]

14. Paragraph (b) permits a creditor to make a joint application for commencement, but limits the application to those group members against which the creditor has a claim; other group members could not be included in a joint application by a creditor.

15. A suggestion made at the thirty-third session of the Working Group was to require a joint application to include facts concerning the existence of the group and the position in the group of each member covered by the application, particularly where one of them is the controlling entity or parent.[12] The Working Group may wish to consider whether a recommendation to that effect should be included.

16. Draft recommendation (2), which addressed provision of notice on the making of a joint application, has, as agreed by the Working Group at its thirty-third session, been deleted.[13] Accordingly, notice of such an application would be given in accordance with the recommendations of part two, chapter I of the Legislative Guide.

B. Procedural coordination

1. Purpose of legislative provisions

[The purpose of provisions on procedural coordination is:

(a) To facilitate coordination of proceedings in the interests of creditors and the debtors, while respecting the separate legal identity of each group member; and

(b) To promote procedural convenience and cost efficiency and avoid duplication of effort.]

2. Contents of legislative provisions

Timing of an application for procedural coordination

(2) [4] The insolvency law should specify that an application for procedural coordination may be made at the time of an application for commencement of insolvency proceedings under recommendations 15 or 16 of the Legislative Guide or at any subsequent time.

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[11] Ibid., para. 34.
[12] Ibid., para. 18.
[13] Ibid., paras. 23-24.

Procedural coordination of two or more insolvency proceedings

(3) The insolvency law should specify that the court may decide, on the basis of an application under recommendation (2), that the administration of insolvency proceedings with respect to two or more members of an enterprise group should be coordinated for procedural purposes.[14]

Parties permitted to apply for procedural coordination

(4) [5] The insolvency law should specify that an application for procedural coordination may be made by:

(a) A member of an enterprise group that has applied for or is subject to insolvency proceedings;

[(b) The insolvency representative of a member of an enterprise group that is subject to insolvency proceedings;] or

(c) A creditor of a member of an enterprise group [in respect of which that creditor has made an application for commencement of insolvency proceedings or that is subject to insolvency proceedings.]

Simultaneous hearings

(5) [6] The insolvency law should specify that the court may hold simultaneous hearings on an application for procedural coordination.

Notice of procedural coordination

(6) [7] The insolvency law should specify that, if the court orders procedural coordination of insolvency proceedings, notice of the order is to be given to all creditors of the members of the enterprise group included in the procedural coordination.

Content of notice of procedural coordination

(7) [8] The insolvency law should specify that the notice of an order for procedural coordination is to include, in addition to the information specified in recommendation 25 of the Legislative Guide, information on the conduct of the procedural coordination of relevance to creditors.

Modification or termination of procedural coordination

[(8) The insolvency law should specify that the court may modify or terminate an order for procedural coordination, provided that any actions or decisions taken pursuant to the order for procedural coordination should not be affected by the order for modification or termination.]

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[14] When the proceedings to be coordinated are taking place in different courts, it is a matter for domestic law to determine which court should consider the application. It is also a matter for domestic law to determine the power courts may have with respect to initiating procedural coordination of insolvency proceedings.

3. Notes on recommendations

17. To better explain the purpose of the draft recommendations on procedural coordination, a topic not addressed in the Legislative Guide, the approach of the Legislative Guide has been adopted and a purpose clause introduced. The Working Group may wish to consider the purposes to be included in this clause.

Timing of an application for procedural coordination

18. At its thirty-third session, the Working Group approved the substance of draft recommendation (2) (previously draft recommendation (4), A/CN.9/WG.V/WP.78).[15] It has been revised to clarify that an application for procedural coordination may be made at the same time as an application for commencement or at any time thereafter.

Procedural coordination of two or more insolvency proceedings

19. Draft recommendation (3) provides the court with discretion to make an order for procedural coordination on the basis of an application by the parties specified in draft recommendation (4).

20. When the insolvency proceedings concerning two or more group members are being administered in different courts (in a domestic context), it is a question for local law to determine issues of judicial competence over the insolvency proceedings and the application for coordination. It is also a matter for domestic law to determine the power that courts may have with respect to initiating procedural coordination of insolvency proceedings. These two issues are included in a footnote to draft recommendation (3).

21. To facilitate judicial coordination, the commentary might indicate criteria relevant to determining which court should coordinate the proceedings. The criteria might include: the priority in which the applications for commencement of insolvency proceedings were filed; the size of the indebtedness or value of assets of the insolvent group members; or the location of the centre of control of the enterprise group. One State, for example, provides that it should be the court competent to hear the insolvency proceedings of the party with the most substantial assets, determined by reference to the latest balance sheet.

Parties permitted to apply for procedural coordination

22. In accordance with the deliberations of the Working Group at its thirty-third session,[16] draft recommendation (4) (previously draft recommendation (5), A/CN.9/WG.V/WP.78) identifies the parties that may apply for procedural coordination, including a group member that has applied for commencement of proceedings or is already subject to proceedings; the insolvency representative of a group member; or a creditor of a member already subject to insolvency proceedings or of a member subject to an application by that creditor for commencement of insolvency proceedings. It may be presumed that the application for procedural coordination would include the group member making the application or the group member of which the applicant is the insolvency representative or a creditor.

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[15] A/CN.9/643, para. 26.

[16] Ibid., paras. 27-28.

Simultaneous hearings

23. The purpose of draft recommendation (5) (previously draft recommendation (6), A/CN.9/WG.V/WP.78) is to simplify the consideration of an application for procedural coordination of proceedings being conducted in different courts, by authorizing simultaneous hearings. It is a question for domestic law to determine which court would be competent to conduct or coordinate the simultaneous hearings.

Notice of procedural coordination

24. Draft recommendation (6) (previously draft recommendation (7), A/CN.9/WG.V/WP.78) has been revised in accordance with the decisions of the Working Group at its thirty-third session.[17] The commentary might refer to the relevant discussion in the Legislative Guide,[18] noting that the requirement for provision of notice might be satisfied with collective notification, such as by publication in an official government gazette, a particular legal publication or commercial or widely circulated newspaper, when domestic legislation so permits.

25. The current version of draft recommendation (6) refers only to the provision of notice of an order for procedural coordination. The Working Group may wish to consider whether the provision of notice should be extended to an application for procedural coordination. Where the application for procedural coordination is made at the same time as the application for commencement of insolvency proceedings, the question of notice may raise issues related to the recommendations of the Legislative Guide concerning provision of notice of an application for commencement of insolvency proceedings. Those recommendations provide that while notice of a creditor application for commencement should be provided to the debtor (recommendation 19), notice of a debtor application for commencement is not required to be given to creditors. If notice of the application for procedural coordination were to be provided to creditors in that situation, it may be inconsistent with the approach of the Legislative Guide with respect to notification of the application for commencement.

26. However, where the application for procedural coordination is made after insolvency proceedings have commenced, the Working Group may wish to consider whether it might be appropriate to provide that all creditors of those members likely to be concerned by the application for procedural coordination should be notified.

Content of notice of procedural coordination

27. Additional information of relevance to creditors referred to in draft recommendation (7) (previously draft recommendation (8), A/CN.9/WG.V/WP.78) might include information on coordination of hearings, filing and processing of claims, financing arrangements and so forth. The Working Group may wish to consider, recalling recommendation 25 of the Legislative Guide, whether more specific examples of that information might be included in the recommendation.

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[17] Ibid., paras. 30-31.

[18] For example, part two, chap. 1, paras. 69-70.

Modification or termination of procedural coordination

28. At its thirty-third session, the Working Group agreed to include a draft recommendation on modification or reversal of an order for procedural coordination,[19] which is reflected in draft recommendation (8). Reversal is not included as an option on the basis that it is likely to prove not only impossible to return the individual group members to the position they were in at the time the order was made, but also undesirable where it involves unwinding actions taken in the administration of the insolvency proceedings that might potentially affect creditors and other parties in interest. Where an order is to be modified or terminated, actions already taken pursuant to the order should be respected and not unwound or changed retroactively by the order for modification or termination. The commentary may include a discussion of the reasons justifying such a modification or termination, for example, that circumstances have changed since the order was made.

C. Post-commencement finance

1. Contents of legislative provisions

Attracting and authorizing post-commencement finance

(9) The insolvency law should facilitate and provide incentives for post-commencement finance to be obtained, in the context of insolvency proceedings with respect to members of an enterprise group, for the reasons and on the basis set forth in recommendation 63 of the Legislative Guide.

(10) The insolvency law should specify that, in accordance with recommendations 64-68 of the Legislative Guide, post-commencement finance may be obtained by a member of an enterprise group that is subject to insolvency proceedings.

Priority for post-commencement finance

(11) The insolvency law should specify that the priority for post-commencement finance referred to in recommendation 64 of the Legislative Guide should also apply to post-commencement finance provided to a member of an enterprise group that is subject to insolvency proceedings.

Security for post-commencement finance

(12) The insolvency law should specify that the security interests referred to in recommendation 65 of the Legislative Guide may also be granted by a member of an enterprise group that is subject to insolvency proceedings for repayment of post-commencement finance provided to another member of that group.[20]

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[19] A/CN.9/643, para. 33.

[20] Recommendations 66-67 of the Legislative Guide set forth the safeguards to apply to the granting of a security interest to secure post-commencement finance. Those safeguards would apply to the granting of a security interest in the enterprise group context.

Guarantee or other assurance for repayment of post-commencement finance

(13) The insolvency law should specify that a member of an enterprise group that is subject to insolvency proceedings may guarantee or provide other assurance of repayment for post-commencement finance obtained by another member of the enterprise group subject to insolvency proceedings, provided:

(a) The insolvency representative of the guarantor [is satisfied][determines] that the creditors of the guarantor will not be [are not likely to be] adversely affected by the guarantee or other assurance of repayment and consents to the provision of that guarantee or other assurance of repayment; or

(b) The court with jurisdiction over the guarantor [is satisfied][determines] that the creditors of the guarantor will not be [are not likely to be] adversely affected by the guarantee or other assurance of repayment.

2. Notes on recommendations

29. At its thirty-third session, the Working Group noted that draft recommendations (9)-(11) repeated key elements of the recommendations of the Legislative Guide and discussed, as a matter of drafting, how the current work should be integrated with the Legislative Guide.[21] The draft recommendations have been retained pending further discussion on drafting techniques. The Working Group approved the substance of draft recommendations (9)-(11), agreeing that the approach of the Legislative Guide with respect to the availability of post-commencement finance in insolvency proceedings generally should be followed.

30. Since draft recommendations (9) and (10) are of a general nature, essentially referring to those recommendations of the Legislative Guide relevant to post-commencement finance, the Working Group may wish to consider whether they could be combined so that a single draft recommendation would refer generally to post-commencement finance being available in the enterprise group context in accordance with recommendations 63-68 of the Legislative Guide.

Priority for post-commencement finance

31. The language of draft recommendation (11), based upon recommendation 64 of the Legislative Guide, has been aligned with the format of the other draft recommendations.

Security for post-commencement finance

32. Draft recommendation (12) is based upon recommendation 65 of the Legislative Guide. It permits one group member subject to insolvency proceedings to grant a security interest for repayment of post-commencement finance paid to another group member also subject to insolvency proceedings. It was observed at the thirty-third session of the Working Group that although the provision of finance by a solvent entity might cause prejudice to its creditors, it was not a matter of insolvency law, but rather one of the law regulating companies, which might require approval of shareholders or directors. However, it was also observed that even

[21] A/CN.9/643, para. 37.

though it might be an issue of company law, a rule might be useful to ensure that post-commencement finance could be made available by a solvent entity in a group context in States where such lending might otherwise be ultra vires.[22]

33. The Working Group discussed the safeguards that might apply to the provision of a security interest under draft recommendation (12), which might parallel those provided under draft recommendation (13). Recommendations 66 and 67 of the Legislative Guide, however, provide safeguards applicable to the granting of a security interest. These include the consent of existing secured creditors and, where that is not given, consent of the court. Accordingly, the Working Group might wish to consider whether the safeguards set forth in recommendations 66 and 67 would be sufficient in the enterprise group context, or whether additional safeguards, such as provided in paragraph (a) of draft recommendation (13) would also be required. If additional conditions are to be added, the Working Group may wish to consider including an explanation of the need for those additional conditions in the commentary.

Guarantee or other assurance for repayment of post-commencement finance

34. Draft recommendation (13) addresses a situation not covered directly by the Legislative Guide, i.e. the granting of a guarantee or other assurance of payment by one group member subject to insolvency proceedings for post-commencement finance paid to another group member subject to insolvency proceedings. Since that situation is not covered directly by the safeguards provided by recommendations 66 and 67 of the Legislative Guide, paragraphs (a) and (b) have been added. Those paragraphs have been revised to take account of the deliberations of the Working Group at its thirty-third session[23] with respect to the test to be satisfied by both the insolvency representative and the court. The Working Group may wish to consider the alternative texts included in square brackets. It was noted at the thirty-third session that where a single insolvency representative was appointed to the insolvency proceedings of several group members, a conflict might arise with respect to the requirements of paragraph (a).[24] Such a conflict should be addressed under draft recommendation (25) below.

35. Paragraphs (a) and (b) are currently drafted as alternatives. Although the Working Group approved that approach, it was acknowledged that the possibility of including both, if required by a State, might be noted in the commentary.[25]

36. At the thirty-third session of the Working Group, a suggestion to include a further requirement that addresses the rationale for, or identifies criteria that could guide, the provision of finance.[26] Both the purpose clause for the recommendations on post-commencement finance and recommendation 63 of the Legislative Guide provide the rationale for post-commencement finance, including that it may be obtained by the insolvency representative where it is determined to be necessary for the continued operation or survival of the business of the debtor or the preservation of the value of the insolvency estate of the debtor. Since that purpose clause and

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[22] Ibid., para. 39.
[23] Ibid., paras. 44-48.
[24] Ibid., para. 44.
[25] Ibid., para. 46.
[26] Ibid., para. 47.

recommendation would apply in the enterprise group context by virtue of draft recommendations (9) or (10), [27] it might not need to be added to draft recommendation (13), depending upon the Working Group's decision with respect to integration of the current text into the Legislative Guide.

37. A further proposal that draft recommendations (12) and (13) might be merged[28] has not been followed on the basis that draft recommendation (12) is based directly upon recommendation 65 of the Legislative Guide, while draft recommendation (13) introduces a means of securing post-commencement finance in the group context that is not addressed in the Legislative Guide.

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[27] Ibid.

[28] Ibid., para. 48.