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Legislative Guide on Insolvency Law

Part three: Treatment of enterprise groups in insolvency

Note by the Secretariat

Contents

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IX. International issues

1. Many of the issues relating to the international treatment of enterprise groups are discussed in documents A/CN.9/WG.V/WP.74/Add.2 and A/CN.9/WG.V/WP.76/Add.2. As requested by the Working Group at its thirty-fourth session (A/CN.9/647, paras. 90-91), the material below presents a summary of the previous discussions, identifying issues, the manner in which they have already been addressed in UNCITRAL texts and possible solutions with respect to 3 key topics – centre of main interests (COMI), post-commencement finance and coordination and cooperation. Other issues addressed in the context of domestic groups, but which might also be addressed in the cross-border context, i.e. procedural coordination, single reorganization plan and substantive consolidation, are also discussed.

A. Jurisdiction to commence insolvency proceedings

(UNCITRAL references: A/CN.9/WG.V/WP.74/Add.2, paras. 5-12; A/CN.9/WG.V/WP.76/Add.2, paras. 2-17)

2. The following discussion considers the possibility of achieving a definition of, or greater certainty with respect to, the concept of COMI (a) for individual group members, and (b) for the group as such.

1. COMI of individual enterprise group members

(a) Issues

3. The international models that have been developed to address cross-border insolvency issues have stopped short of dealing with enterprise groups. Accordingly, there is currently no means of commencing insolvency proceedings against an enterprise group as such. Separate proceedings must be commenced against each group member in the relevant jurisdiction, based on the applicable commencement standards, with recognition of those proceedings being sought, where relevant, in other jurisdictions (using the Model Law, where applicable).

4. The *Legislative Guide* recommends that the insolvency law should specify those debtors that have sufficient connection to the State to be subject to the insolvency law (recommendation 10). The two approaches included are taken from the Model Law: COMI or establishment in a State. Commencement standards are addressed in recommendations 15 and 16 of the *Legislative Guide*.

5. There is no single, internationally agreed definition of what constitutes COMI; it is not defined in the Model Law nor the *Legislative Guide*. The EC Regulation, however, does include an indication that it should be "the place where the debtor conducts the administration of his interests on a regular basis and is therefore ascertainable by third parties" (recital 13). Both the *Legislative Guide* (recommendation 11) and the Model Law (article 16 (3)) include a rebuttable presumption that a debtor's registered office is its centre of main interests. One issue in the cross-border context is identifying the appropriate court to make the determination as to COMI with respect to enterprise group members and whether other courts would follow that determination.

6. Factors 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; and the location where design, marketing, pricing, delivery of products and office functions were conducted.

7. In contrast to COMI, both the *Legislative Guide* and the Model Law define establishment (recommendation 12/article 2 (f)).

(b) Solutions

8. To provide more certainty as to what constitutes a debtor's COMI, a definition of what constitutes COMI or a recommendation identifying the factors to be considered in determining what is the COMI in a given case could be developed.

9. To be successful, that definition or recommendation would need to be internationally recognized, accepted and widely adopted. Should the Working Group wish to consider developing such a definition or recommendation, it may also consider what type of text might best achieve that wide acceptance and application.

2. COMI of an enterprise group

(a) Issues

10. As an alternative to multiple proceedings, it might be possible in some cases to commence, in a single State, insolvency proceedings against different group members located in different States. Neither the *Legislative Guide* nor the Model Law addresses that issue. The key issue is identifying the State in which those proceedings should commence.

(b) Solutions

11. Identifying the jurisdiction most central for an enterprise group might be assisted by developing a concept of an "enterprise group COMI" or developing a rule deeming the COMI of the group to be a specific location, for example, the place of registration of the parent of the group or the place where it conducts its business activities. Consideration might need to be given to how that concept or rule might best be implemented to achieve wide support and adoption, as noted in paragraph 9 above. Developing a COMI for an enterprise group might support reduction of the costs of parallel proceedings; coordination of a global sale of assets; maximization of the value of all group members; reduction of forum shopping; and global reorganization of the group.

12. At the same time, however, there might be certain disadvantages. Creditors would need to investigate the connections of a company with which they deal to ascertain whether or not it is part of a group; there may be a disconnection between the place of business of a group member and the place in which insolvency proceedings with respect to that member could be commenced; where the COMI was to be determined by reference to a basket of factors, it might not always be possible to ascertain the proper location of the COMI before insolvency proceedings commenced; the standard would require global recognition in order to avoid further

risk of disconnection and overlapping and conflicting claims and procedures; and a definition of "enterprise group" would be required to ensure a common understanding as to what constituted a group member, including specifying the requisite level of integration if close integration was a determinative factor. Where the COMI of the group was specified to be the location of the parent, difficulties might arise where the parent was not insolvent, but group members located elsewhere were insolvent.

13. If a group COMI could only be determined for a group that was closely integrated, factors establishing the requisite degree of integration would need to be identified. These might include: the extent of group members' independence with respect to financial, management and policy decision-making ("head of the office functions"); financial arrangements between group members, 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; and third-party perceptions, in particular those of creditors, concerning that location.

14. The "*Transnational Insolvency Principles of Cooperation among NAFTA countries*" (the NAFTA Principles) recommend two rules that might be considered.[1]

> Principle 23 provides 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.[2]
>
> Principle 24 provides that enterprise groups should be reorganized from a global perspective, subject to the necessity of allocating value with regard to the corporate form.[3]

15. The Principles provide an exception for those situations where either the main jurisdiction or the subsidiary's jurisdiction requires 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.

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[1] Developed by the American Law Institute, 2003, as part of its transnational insolvency project, available at www.ali.org.

[2] 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.

[3] 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.

B. Post-commencement finance

(UNCITRAL references: A/CN.9/WG.V/WP.74/Add.2, paras. 15-22; A/CN.9/WG.V/WP.76/Add.2, paras. 20-25)

16. Many jurisdictions do not address the issue of new finance in insolvency or restrict its provision. Even where insolvency laws permit post-commencement finance on a domestic basis, there are different approaches to the priority that might be accorded or the security that might be granted to facilitate the provision of post-commencement finance, as well as issues of applicable law, that are potentially difficult to address when post-commencement finance is provided in a cross-border context.

1. Issues

(a) Obtaining and authorizing post-commencement finance

17. Recommendation 63 of the *Legislative Guide* provides that post-commencement finance may be obtained by an insolvency representative and authorized by the court or consented to by creditors. This recommendation would apply in the case of a single debtor and also in the group context where post-commencement finance is provided by a solvent group member to another group member, whether that member was solvent or subject to insolvency proceedings. Draft recommendation 10 above (A/CN.9/WG.V/WP.82/Add.2) covers provision of post-commencement finance by a group member subject to insolvency proceedings to another such group member.

18. A number of questions arise with respect to obtaining and authorizing post-commencement finance in the cross-border group context. These might include:

(a) Could one group member obtain finance in its own jurisdiction and provide it to a group member in another jurisdiction?

(b) Which insolvency representative would be regarded as obtaining the finance and what implications of personal liability would there be for the insolvency representative or for officers and directors of the two group members?

(c) Would court approval or creditor consent be required in the jurisdiction of the group member obtaining the finance or in the jurisdiction of the group member receiving the finance or perhaps both?

(d) Would one court's approval of post-commencement finance have effects in the other jurisdiction?

(e) Would both jurisdictions recognize orders made in the other affecting the provision of post-commencement finance in the group context?

(f) To what extent, if any, would the requirement for authorization depend on the terms of the post-commencement finance?

(g) Are there any particular issues that might arise where it was possible for a single insolvency representative to be appointed with respect to group members in different States?

(b) Priority for post-commencement finance

19. Recommendation 64 of the *Legislative Guide* specifies the level of priority to be accorded to post-commencement finance that would apply where post-commencement finance was provided by a solvent group member to a group member subject to insolvency proceedings. Draft recommendation 11 above (A/CN.9/WG.V/WP.82/Add.2) provides that in the case of post-commencement finance provided by one group member subject to insolvency proceedings to another such group member, the insolvency law should specify the level of priority to be accorded; where not specified by the law, the level of the priority should be determined by the court. The specific level of priority is not indicated in the draft recommendation.

20. Several questions may need to be considered with respect to priority, including:

(a) Will the priority accorded in one State be recognized in another where the finance transaction takes place within the same enterprise group?

(b) Will the distinction, in terms of the priority to be accorded, between provision of finance by a solvent group member and provision by a group member subject to insolvency proceedings, be affected by the cross-border nature of the transaction?

(c) Is the question of authorization affected where different priorities are accorded in different jurisdictions?

(c) Security for post-commencement finance

21. Recommendations 65-66 of the *Legislative Guide* address the granting of security for post-commencement finance. Recommendation 67 addresses the procedure to be followed where priority over existing security interests is sought. These recommendations would apply in the group context where the security interest was granted by a solvent group member to secure finance provided to another solvent group member or to a group member subject to insolvency proceedings.

22. Draft recommendation 12 above (A/CN.9/WG.V/WP.82/Add.2) addresses the granting of a security interest by one group member subject to insolvency proceedings to secure finance provided to another such group member. It permits the type of security interest referred to in recommendation 65 of the *Legislative Guide* to be granted, provided creditors consent or a determination is made that any harm to creditors is offset by the benefit to be derived from the granting of the security interest.

23. Questions relating to granting of a security interest that might need to be considered include:

(a) Would a security interest granted in one jurisdiction be recognized as valid and enforceable in another jurisdiction?

(b) If the existing secured creditors in one jurisdiction objected to the encumbrance of assets in that jurisdiction (in accordance with recommendation 66 of the *Legislative Guide*) to secure finance provided in another jurisdiction, would the court approve that security interest and in what circumstances and subject to

what conditions? If the court in the jurisdiction receiving the benefit of the security interest was required to approve that transaction, could it do so and on what basis?

(c) Are there any special considerations that would arise in the situation contemplated by recommendations 66-67 of the *Legislative Guide* where a cross-border grant of security is contemplated?

(d) Provision of guarantees

24. Draft recommendation 13 above (A/CN.9/WG.V/WP.82/Add.2) provides that an enterprise group member subject to insolvency proceedings may guarantee repayment of post-commencement finance obtained by another such member, with the same proviso as applies to the granting of a security interest (draft recommendation 12). The questions raised above with respect to the granting of a security interest might also arise with respect to provision of a guarantee.

2. Solutions

25. The draft recommendations concerning provision of post-commencement finance in the context of enterprise groups in the domestic context (i.e. draft recommendations 10-13) might be revised appropriately to address some of the situations raised above. The Working Group might wish to consider the recommendations of the UNCITRAL Legislative Guide on Secured Transactions concerning conflict-of-laws rules applicable to security interests and their application to cross-border provision of post-commencement finance.

C. Coordination and cooperation

26. Achieving a coordinated result for the insolvency of one or more enterprise group members located in different States depends upon whether the different proceedings commenced with respect to each member can be recognized in other jurisdictions and whether parties involved in the various proceedings can cooperate to ensure coordination of the proceedings. In those States that have adopted the Model Law,[4] 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.[5] 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.[6] Because of the absence of

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[4] Adopted in Australia (2008), British Virgin Islands, overseas territory of the United Kingdom of Great Britain and Northern Ireland (2005), Eritrea (1998), Colombia (2006), Great Britain (2006), Japan (2000), Mexico (2000), Montenegro (2002), New Zealand (2006), Poland (2003), Republic of Korea (2006), Romania (2003), Serbia (2004), South Africa (2000) and United States of America (2005).

[5] See Model Law: art. 17 on decision to recognize and arts. 20 and 21 on effects of recognition.

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

such provisions, achieving a coordinated result can be time-consuming, costly and, in some cases, impossible.

27. With reference to the discussion of group COMI above, it should be noted that in practice a high level of coordination of multiple proceedings with respect to group members has been achieved in several cases through the use of cross-border agreements, with the result that proceedings concerning many, if not all, group members could be managed from a single location.

28. The Working Group will have before it a note by the Secretariat "Draft UNCITRAL Notes on cooperation, coordination and communication in cross-border insolvency cases" (A/CN.9/WG.V/WP.83). The Working Group may wish to consider the extent to which that document sufficiently addresses the issues of coordination and cooperation in the enterprise group context.

D. Other issues

1. Procedural coordination

29. As an alternative to giving greater definition to COMI with respect to each individual enterprise group member, some form of procedural coordination across borders might also be possible. Procedural coordination of insolvency proceedings with respect to enterprise group members in the domestic context is discussed above (draft recommendations 3-9, A/CN.9/WG.V/WP.82/Add.1).

30. The Working Group might wish to consider whether draft recommendations 3-9 above on procedural coordination might be extended to address cross-border situations and what, if any, conditions might apply.

2. Substantive consolidation

31. This issue is addressed in the enterprise group context by draft recommendations 16-25 above (A/CN.9/WG.V/WP.82/Add.3). The Working Group may wish to consider the desirability of seeking to achieve substantive consolidation in cross-border cases and, if so, whether the draft recommendations might be revised to achieve that goal.

3. Appointment of a single insolvency representative

32. This issue is addressed in the enterprise group context by draft recommendations 26-30 above (A/CN.9/WG.V/WP.82/Add.3). Of those draft recommendations, recommendations 28-30 build upon the coordination and cooperation provisions of the Model Law. The Working Group may wish to consider the desirability of seeking to appoint a single insolvency representative in cross-border insolvency cases and, if so, how those draft recommendations might be revised for application in that context.

4. Single reorganization plan

33. This issue is addressed in the enterprise group context by draft recommendations 31-32 above (A/CN.9/WG.V/WP.82/Add.3). The Working Group may wish to consider the desirability of achieving a single reorganization plan in

cross-border insolvency proceedings and, if so, how those draft recommendations might be revised for application in that context.

34. One approach, at a regional level, that might be considered is proposed by the NAFTA Principles, 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."

35. 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 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. 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.

36. The operation of the 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.