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Treatment of enterprise groups in insolvency

Note by the Secretariat

C. Remedies – substantive consolidation

(References to previous UNCITRAL documents: A/CN.9/WG.V/WP.74/Add.1, paras. 35-45; A/CN.9/618, paras. 36-42; A/CN.9/WG.V/WP.76/Add.1, paras. 21-38; A/CN.9/622, paras. 61-65)

1. General remarks

1. Because of the nature of enterprise groups and the way in which they operate, there may be a complex web of financial transactions between members of the group, and creditors may have dealt with different members or even with the group as a single economic entity, rather than with members individually. Disentangling the ownership of assets and liabilities and identifying the creditors of each member of the group may involve a complex and costly legal inquiry. However, because adherence to the separate entity approach means that each group member is only liable to its own creditors, it may become necessary, where insolvency proceedings have commenced against one or more of the members of that group, to disentangle the ownership of their assets and liabilities.

2. When this disentangling can be effected, adherence to the separate entity principle operates to limit creditor recovery to the assets of that specific group member. Where it cannot be effected or other specified reasons exist to treat the group as a single enterprise, some laws include remedies that allow the single entity approach to be set aside. Historically, these remedies have been developed to overcome the perceived inefficiency and unfairness of the traditional separate entity approach in specific group cases. In addition to setting aside intra-group transactions or subordinating intra-group lending, the remedies include: extending

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liability for external debts to other solvent members of the group, as well as to office holders and shareholders; contribution orders; and pooling or substantive consolidation orders. Some of these remedies require findings of fault to be made, while others rely upon the establishment of certain facts with respect to the operations of the enterprise group. In some cases, particularly where misfeasance of management is involved, other remedies might be more appropriate, such as removal of the offending directors and limiting management participation in reorganization.

3. Because of the potential inequity that may result when one group member is forced to share assets and liabilities with other group members that may be less solvent, remedies setting aside the single entity approach are not universally available, generally not comprehensive and apply only in restricted circumstances. Those remedies involving extension of liability may involve "piercing" or "lifting the corporate veil", by which shareholders, who are generally shielded from liability for the enterprise's activities, can be held liable for certain activities. The other remedies discussed here do not, although in some circumstances the effect may appear to be similar.

4. As noted above, where procedural coordination occurs, the assets and liabilities of the debtors remain separate and distinct, with the substantive rights of claimants unaffected. Consolidation, however, permits the court, in insolvency proceedings involving two or more members of the same enterprise group, to disregard the separate identity of each group member in appropriate circumstances and consolidate their assets and liabilities, treating them as though held and incurred by a single entity. This has the effect of creating a single estate for the general benefit of all creditors of all consolidated group members. Consolidation would generally involve the group members against which insolvency proceedings had commenced, but in some cases might extend to a solvent group member, where the affairs of that member were so closely intermingled with those of other group members that it would be beneficial to include it in the consolidation. While typically requiring a court order, consolidation may also be possible on the basis of consensus of the relevant interested parties or by way of a reorganization plan.

5. Few jurisdictions provide statutory authority for consolidation orders and where the remedy is available, in general it is not widely used. Notwithstanding the absence of direct statutory authority or a prescribed standard for the circumstances in which such orders can be made, the courts of some jurisdictions have played a direct role in developing these orders and delimiting the appropriate circumstances. This practice reflects increased judicial recognition of the widespread use of interrelated corporate structures for taxation and business purposes. The circumstances that would support a consolidation order are very limited and tend to be those where a high degree of integration of the members of a group, through control or ownership, would make it difficult, if not impossible, to disentangle the assets and liabilities of the different group members and administer the estate of each debtor separately.

6. Consolidation is typically discussed in the context of liquidation and the legislation that does authorize such orders does so only in that context. There are, however, legislative proposals that would permit consolidation in the context of various types of reorganization. In jurisdictions without specific legislation,

consolidation orders may be available in both liquidation and reorganization, where such an order would, for example, assist the reorganization of the group.

7. Consolidation might be appropriate where it leads to greater return of value for creditors, either because of the structural relationship between the members of the group and their conduct of business and financial relationships or because of the value of assets common to the whole group, such as intellectual property in both a process conducted across numerous group members and the product of that process. A further situation might occur where there is no real separation between the members of a group, and the group structure is being maintained solely for dishonest or fraudulent purposes. .

8. The principal concerns with the availability of such orders, in addition to those associated with the fundamental issue of overturning the separate entity principle, include, the potential unfairness caused to one creditor group when forced to share pari passu with creditors of a less solvent group member and whether the savings or benefits to the collective class of creditors outweighs incidental detriment to individual creditors. Creditors opposing consolidation could argue that as they relied on the separate assets of a particular group member when trading with it, they should not be denied a full payout because of their trading partner's relationship with another member of the same group. Creditors supporting consolidation could argue that they had relied upon the assets of the whole group and that it would be unfair if they were limited to recovery against the assets of a single group member.

9. Because it involves pooling the assets of different group members, consolidation may not lead to increased recovery for each creditor, but rather operate to level the recoveries across all creditors, increasing the amount distributed to some at the expense of others. Additionally, the availability of consolidation may enable stronger, larger creditors to take advantage of assets that should not be available to them; encourage creditors who disagree with such an order to seek review of the order, thus prolonging the insolvency proceedings; and damage the certainty and foreseeability of security interests (where intra-group claims disappear as a result of consolidation, creditors that have security interests in those claims would lose their rights).

(a) Circumstances supporting consolidation

10. A number of elements have been identified as relevant to determining whether or not substantive consolidation is warranted, both in the legislation that authorizes consolidation orders and where the courts have played a role in developing those orders. In each case it is a question of balancing the various elements; no single element is necessarily conclusive and all of the elements do not need to be present in any given case. Those elements include: the presence of consolidated financial statements for the group; the use of a single bank account for all group members; the unity of interests and ownership between the group members; the degree of difficulty in segregating individual assets and liabilities; sharing of overhead, management, accounting and other related expenses among different group members; the existence of intra-group loans and cross-guarantees on loans; the extent to which assets were transferred or funds shifted from one member to another as a matter of convenience without observing proper formalities; adequacy of capital; commingling of assets or business operations; appointment of common directors or officers and the holding of combined board meetings; a common

business location; fraudulent dealings with creditors; the practice of encouraging creditors to treat the group as a single entity, creating confusion among creditors as to which of the group members they were dealing with and otherwise blurring the legal boundaries of the group members; and whether consolidation would facilitate a reorganization or is in the interests of creditors.

11. While these many factors remain relevant, some courts have started to focus on several factors in particular, namely, whether creditors dealt with the group as a single economic unit and did not rely on the separate identity of individual group members in extending credit, and whether the affairs of the group members are so intermingled that separating asset and liabilities can only be achieved at extraordinary cost and expenditure of time and consolidation will benefit all creditors.

(b) Competing interests in consolidation

12. In addition to the competing interests of the creditors of different members of a group, the competing interests of different stakeholders warrant consideration in the context of consolidation, in particular those of creditors and shareholders; of shareholders of the different group members, and in particular those who are shareholders of some of the members but not of others; and of secured and priority creditors of different members of a consolidated group.

(i) Owners and equity holders

13. Many insolvency laws adopt the general rule that the rights of creditors outweigh those of owners and equity holders, with owners and equity holders being ranked after all other claims in the order of priority for distribution. Often this results in owners and equity holders not receiving a distribution. In the enterprise group context, the shareholders of some group members with many assets and few liabilities may receive a return, while the creditors of other group members with fewer assets and more liabilities may not. If the general approach of ranking shareholders behind unsecured creditors were to be extended, in consolidation, to the group as a whole, all creditors could be paid before the shareholders of any group member received a distribution.

(ii) Secured creditors

14. With respect to secured creditors, both internal and external to the group, there is a question of how their rights should be treated in a consolidation. The Legislative Guide on Insolvency Law discusses the position of secured creditors in insolvency proceedings and adopts the approach that while as a general principle the effectiveness and priority of a security interest should be recognized and the economic value of the encumbered assets should be preserved in insolvency proceedings, an insolvency law may nevertheless modify the rights of secured creditors in order to implement business and economic policies, subject to appropriate safeguards.

15. Questions arising with respect to consolidation might include: whether a security interest over some or all of the assets of one group member could extend to include assets of another group member where a consolidation order was made or whether that security interest should be limited to the defined pool of assets upon

which the secured creditor had originally relied; whether secured creditors with insufficient security could claim the remaining debt against the pooled assets as unsecured creditors; and whether internal secured creditors (i.e. creditors that are other members of the same group) should be treated differently to external secured creditors. In this respect, it might be useful to consider devising different solutions for security interests encumbering specific assets and security interests encumbering the whole estate.

16. One solution with respect to external secured creditors might be to exclude them from the process of consolidation, thus achieving what might be a partial consolidation. Individual secured creditors that relied upon the separate identity of group members, such as where they relied upon an intra-group guarantee, might require special consideration. Where encumbered assets are required for reorganization, a different solution might be possible, such as allowing the court to adjust the consolidation order to make specific provision for such assets or requiring the consent of the affected secured creditor. The interests of internal secured creditors also need to be considered. Different approaches might include cancelling internal security interests, leaving the creditors with an unsecured claim, or modifying or subordinating those interests.

(iii) Priority creditors

17. Similar questions arise with respect to the treatment of priority creditors. Practically, they might benefit or lose from the pooling of the group's assets in the same way as other unsecured creditors. Where priorities, such as those for employee benefits or tax, are based on the single entity principle, a question arises as to how they should be treated across the group, especially where they interact with each other. For example, employees of a group member that has many assets and few liabilities will potentially compete with those of a group member in the opposite situation, with few assets and many liabilities if there is consolidation. While priority creditors generally might obtain a better result at the expense of unsecured creditors without priority, the different groups of those priority creditors might have to adjust any expectations arising out of their priority position with respect to the assets of a single entity.

(c) Notification of creditors

18. The potential impact of consolidation on creditor rights suggests that affected creditors should have the right to be notified of any application for consolidation and the right to object. The interests of individual creditors who may have relied upon the separate identity of each group member in their dealings would have to be weighed against the overall benefit to be gained by consolidation. One issue to be considered is whether a single objection would be sufficient to prevent consolidation or whether consolidation could nevertheless be ordered. It may be possible, for example, to provide objecting creditors who will be significantly disadvantaged by the consolidation relative to other creditors with a substantially greater level of return than other unsecured creditors, thus departing from the strict policy of equal distribution. It may also be possible to exclude specific groups of creditors with certain types of contracts, for example limited recourse project financing arrangements entered into with clearly identified group members at arm's length commercial terms.

(d) Timing and inclusion of additional group members over time

19. Additional issues to be considered with respect to consolidation orders include the timing of such an order (whether it could only be made at an early stage of the proceedings or later when it emerged that to do so would enhance the value to be distributed to creditors) and whether an additional group member could be added to an existing consolidation. If the consolidation order is made with the consent of the creditors, or if creditors are given the opportunity to object to a proposed order, the addition of another group member at a later stage of the proceedings has the potential to vary the pool of assets from what was originally agreed or notified to creditors. In that situation, it is desirable that creditors have a further opportunity to consent or object to the addition to the consolidation.

2. Recommendations

Substantive consolidation

(16) The insolvency law should respect the separate legal identity of each member of an enterprise group, except as provided in recommendations 17 and 18.

(17)[1] [22] The insolvency law [may] [should] specify that the court may order insolvency proceedings against two or more members of a group to proceed together and consolidate the assets and liabilities of those members as if they were incurred by a single entity in the following limited circumstances:

(a) Where there was such an intermingling of assets between the group members subject to insolvency proceedings that it was impossible to identify the ownership of individual assets; or

(b) Where the debtor[s] established different entities for the purpose of engaging in simulation or fraudulent schemes or created fictitious structures with no legitimate business purpose and consolidation is appropriate to rectify the fraudulent or fictitious structure.

(18) [22] The insolvency law should specify that the court may also order consolidation in appropriate circumstances, for the [overall] benefit of creditors where:

(a) Creditors had dealt with the members of a group as a single economic unit and did not rely upon the separate identity of members in extending credit; or

(b) […].

3. Notes on recommendations

20. Draft recommendation (16) has been added to emphasize a key point made with respect to consolidation by the Working Group at its thirty-second session[2] that the insolvency law should respect the separate legal identity of each member of a group. As drafted, recommendation (16) is of general application and, although of

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[1] The recommendations in A/CN.9/WP.76/Add.1 were incorrectly numbered and recommendation (21) should have been (22) – the revised numbering has been used in the Report of Working Group V (Insolvency Law) on the work of its thirty-second session, A/CN.9/622.

[2] A/CN.9/622, para. 67.

key importance in the context of consolidation, the Working Group might wish to consider whether it could form a general recommendation in the introduction to this work. It might also wish to consider whether that recommendation should refer to the insolvency law or to the law more generally.

21. Draft recommendation (17) (previously recommendation [22] of A/CN.9/WG.V/WP.76/Add.1) has been revised to emphasize that consolidation should be available by order of the court only in the limited circumstances specified in paragraphs (a) and (b). While the Working Group agreed at its thirty-second session that overall benefit to creditors should be a key factor in a court ordering consolidation,[3] there are circumstances in which consolidation may be warranted irrespective of the benefit provided to creditors. Those situations, set forth in draft recommendation (17), occur where the assets are intermingled to such a degree that it is impossible to identify ownership, and where there are fraudulent schemes. In both of those situations, the question of whether or not consolidation will be of benefit to creditors is not the primary consideration as there will be limited alternatives to address those specific situations.

22. Accordingly, the factor of overall benefit to creditors has been removed from draft recommendation (17) and placed in a new draft recommendation (18), which is intended to address situations additional to those set forth in draft recommendation (17), where benefit to creditors will be the determining factor in making an order for consolidation. One example is given, which was previously paragraph (b) of recommendation [22]. The question of whether a sufficient numbers of creditors relied on the single economic unit to justify an order for consolidation is a matter of evidence for the court to determine. Accordingly, no qualifying element has been added to the draft recommendation in order to avoid uncertainties of interpretation that may be a consequence of such qualifications. Any commentary to the draft recommendation could make clear however, that, as consolidation should only be ordered in limited circumstances, reliance of a significant number or of the majority of creditors should be required for a consolidation order. The Working Group may wish to consider whether there are additional circumstances in which the court might exercise the power to order consolidation under recommendation (18).

4. Additional questions on substantive consolidation

23. The Working Group may wish to consider a number of additional issues with respect to substantive consolidation. Some of those issues were previously included in document A/CN.9/WG.V/WP.76/Add.1 as follows:

(a) Paragraphs 31-35 of document A/CN.9/WG.V/WP.76/Add.1 raise questions with respect to the treatment of competing interests in consolidation, including those of owners and equity holders, secured creditors and priority creditors. Paragraph 34 raises the possibility of ordering partial consolidation and excluding certain interests or assets from the pool of consolidated assets;

(b) Paragraph 37 of document A/CN.9/WG.V/WP.76/Add.1 raises the issue of providing notice of an application for consolidation and to whom it should be

[3] A/CN.9/622, para. 71.

given. It also discusses how creditors' objections to consolidation might be treated; and

(c) Paragraph 38 of document A/CN.9/WG.V/WP.76/Add.1 raises the issue of the timing of an order for consolidation and whether additional members could be added to an existing consolidation. The Working Group may wish to consider whether consolidation might be ordered at any time before, for example, a distribution in liquidation or the approval of a reorganization plan or sale of the business as a going concern, or whether such a limit is not necessary. In reorganization, for example, the plan might include provision for consolidation that creditors would approve or reject as part of the plan approval process.

24. Other issues might include:

(a) The parties that may make an application for consolidation, such as for example, the insolvency representative, the court on its own motion or a creditor; and

(b) The effect of consolidation on calculation of the suspect period for the purpose of avoidance proceedings. Recommendation 89 of the Legislative Guide refers to the suspect period being calculated retrospectively from a specified date, being either the date of application for, or commencement of, insolvency proceedings. The Working Group may wish to consider whether establishing a single date from which the suspect period would be calculated for all of the consolidated entities would be desirable, bearing in mind the effect that a single date might have upon third and relying parties.

D. Participants

1. Appointment of an insolvency representative

(References to previous UNCITRAL documents: A/CN.9/WG.V/WP.74/Add.1, paras. 14-15; A/CN.9/618, paras. 25-26; A/CN.9/WG.V/WP.76, paras. 33-37; A/CN.9/622, paras. 32-35)

(a) General remarks

25. Procedural coordination of the different estates of group members subject to insolvency proceedings 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 group as a whole.

26. 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.

27. Where a single insolvency representative is appointed to administer a group involving multiple debtors with complex financial and business relationships and 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 provide an undertaking or be subject to a practice rule or statutory obligation to seek direction from the court. Additionally, the insolvency law could provide for the appointment of one or more further insolvency representatives to administer the entities in 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.

28. 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; approval or implementation of agreements with respect to division of the exercise of powers and allocation of responsibilities between insolvency representatives; 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; coordination of filing and admission of claims and distributions to creditors.

29. 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 various 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.

(b) Recommendations

Appointment of a single insolvency representative

(19) [9] The insolvency law should specify that, where the court determines that insolvency proceedings against two or more members of a group should be procedurally coordinated, a single insolvency representative may be appointed, consistent with recommendations 115-125 of the Legislative Guide, to conduct that procedural coordination.

Conflict of interest

(20) [10] The insolvency law should specify measures to address a conflict of interest that might arise between the estates of two or more members of an enterprise group in a procedural coordination where only one insolvency representative is initially appointed. Such measures may include the appointment of one or more additional insolvency representatives.

(c) Notes on recommendations

30. Draft recommendation (19) (previously draft recommendation [9] of A.CN.9WG.V/WP.76) has been revised to incorporate a reference to the provisions of the Legislative Guide concerning appointment of the insolvency representative,

as those recommendations should apply equally to the context of insolvency proceedings against members of an enterprise group.

31. Draft recommendation (20) (previously draft recommendation [10] of A.CN.9WG.V/WP.76) has been revised in accordance with the decision of the Working Group at its thirty-second session[4] to include the possibility of appointing more than one insolvency representative in the situation where there is a conflict of interest between the estates of two or more members of an enterprise group.

2. Coordination of multiple proceedings against members of an enterprise group

(References to previous UNCITRAL documents: A/CN.9/WG.V/WP.74/Add.1, para. 14; A/CN.9/WG.V/WP.76, para. 36; A/CN.9/622, para. 35)

(a) Recommendations

Cooperation between two or more insolvency representatives in a group context

(21) The insolvency law should specify that where insolvency proceedings are commenced against two or more members of an enterprise group, the insolvency representatives appointed to those proceedings should cooperate to the maximum extent possible to facilitate coordination of those proceedings

Cooperation between two or more insolvency representatives in procedural coordination

(22) [11] The insolvency law should specify that, where more than one insolvency representative is appointed in insolvency proceedings subject to procedural coordination, the insolvency representatives should cooperate to the maximum extent possible to facilitate coordination of those proceedings.

Forms of cooperation

(23) The insolvency law should specify that cooperation to the maximum extent possible may be implemented by any appropriate means, including:

(a) Sharing and disclosure of information, in accordance with applicable law;

(b) Approval or implementation of agreements with respect to division of the exercise of powers and allocation of responsibilities between insolvency representatives;

(c) Coordination with respect to proposal and negotiation of reorganization plans; and

(d) Coordination with respect to administration and supervision of the debtors' affairs and continuation of its business, including post commencement financing; safeguarding of assets; use and disposition of assets; use of avoidance powers; filing and approval of claims and distributions to creditors.

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[4] A/CN.9/622 para. 34.

(b) Notes on recommendations

Cooperation between two or more insolvency representatives in a group context

32. Draft recommendation (21) establishes a general principle that insolvency representatives appointed to different proceedings involving two or more members of an enterprise group should cooperate to facilitate coordination of those proceedings, even where there is no order for procedural coordination. Such cooperation would be in the interests of efficiency and cost effectiveness, as well as of achieving the best solution for the insolvent members of the group and other interested parties.

Cooperation between two or more insolvency representatives in procedural coordination

33. Draft recommendation (22) (previously draft recommendation [11] of A/CN.9/WG.V/WP.76) reflects the same principle as draft recommendation (21) in the context of procedural coordination.

Forms of cooperation

34. Draft recommendation (23) reflects the decision of the Working Group at its thirty-second session that practical examples of the manner in which cooperation to the maximum extent could be achieved, as set forth in paragraph 36 of A/CN.9/WG.V/WP.76, should be added to the draft recommendations.[5] These examples draw upon article 27 of the UNCITRAL Model Law on Cross-Border Insolvency. The reference in paragraph (a) to "in accordance with applicable law" is intended to include the approach of those laws that permit certain actions provided they are specified, as well as that of other laws that permit any actions not specifically prohibited.

3. Creditors

35. Paragraph 49 of document A/CN.9/WG.V/WP.76/Add.1 identifies a number of issues relating to the treatment of creditors that have not yet been discussed by the Working Group. Those issues are repeated here for ease of reference:

(a) Particular considerations that would apply to creditor participation in insolvency proceedings in a group context where that creditor is a members of the same group as the entity subject to insolvency proceedings;

(b) The possibility of establishing a single creditor committee for creditors of each member of a group or each type of creditor across a group;

(c) With respect to creditor representation, the special considerations that might apply to the application of recommendations 126-136 of the Legislative Guide, which address creditor participation. Members of a group that are creditors of other members of the group might be considered to be related parties for the purpose of recommendation 131 and therefore disqualified from participating in creditor committees (see above, avoidance of contracts involving related parties, A/CN.9/WG.V/WP.78, paras 44-45); and

[5] A/CN.9/622 para. 35.

(d) The application of recommendations 137-138 of the Legislative Guide, which address rights of parties in interest to be heard and to appeal, to a member of a group: "party in interest" as explained in the Legislative Guide would include a member of a group in various possible ways, whether as a fellow debtor in joint proceedings, as a creditor, an equity holder, or simply as another member of the same group.

E. Reorganization

(References to previous UNCITRAL documents: A/CN.9/WG.V/WP.74/Add.1, paras. 21-23; A/CN.9/618, para. 35; A/CN.9/WG.V/WP.76/Add.1, paras. 40-45; A/CN.9/622, paras. 74-75)

1. General remarks

36. Where reorganization proceedings are commenced against two or more members of an enterprise group, irrespective of whether or not those proceedings are to be procedurally coordinated, there is a question of whether it will be possible to reorganize the debtors through a single reorganization plan that has the potential to deliver savings across the group's insolvency proceedings, ensure a coordinated approach to the resolution of the group's financial difficulties, and maximize value for creditors. Several insolvency laws permit the negotiation of a single reorganization plan. Under some laws this approach is only possible where the proceedings are procedurally coordinated or substantively consolidated. Where that is not permitted, a single reorganization plan would generally only be possible where the proceedings could, as a matter of practice, be coordinated on a voluntary basis.

37. If the insolvency law were to permit a single reorganization plan to be prepared and approved, consideration would need to be given to the application of a number of the provisions of the Legislative Guide relating to reorganization of a single debtor to the case of a group. Relevant provisions might include those relating to: parties competent to propose the plan or participate in its proposal; nature and content of a plan; safeguards concerning a plan; convening and conduct of creditors meetings in respect of a plan; classification of claims and classes of creditors; voting of creditors and approval of a plan; objections to approval of the plan (or confirmation where it is required); and implementation of a plan.

38. A single reorganization plan would need to take into account the different interests of the different groups of creditors, including the possibility that providing varying rates of return for the creditors of different group members might be desirable in certain circumstances. Achieving an appropriate balance between the rights of different groups of creditors with respect to approval of the plan, including appropriate majorities, both among the creditors of a single group member and between creditors of different group members is also desirable. Calculation of applicable majorities in the group context may require consideration of how creditors with the same claim against different group members, where the claims may have different priorities, should be counted for voting purposes. Some consideration may also need to be given to whether rejection by the creditors of one of several group members might prevent approval of the plan and the consequences

such rejection would apply. One approach might be based upon provisions applicable to the approval of a reorganization plan for a single debtor. Another approach might be to devise different majority requirements that are specifically designed to facilitate approval in the group context. Safeguards analogous to those in recommendation 152 of the Legislative Guide could also be included, with an additional requirement that the plan should be fair as between the creditors of different group members.

39. An insolvency law might also include provisions addressing the consequences of failure to approve such a reorganization plan as addressed by recommendation 158, One law, for example, provides that the consequence of failure to approve a plan is the liquidation of all insolvent members of the group. Where solvent members are included in the plan by consent, special provisions may be required to prevent undue advantages arising from that liquidation.

2. Recommendations

Reorganization plan

(24) [23-24] Subject to recommendations 139-159 of the Legislative Guide, the insolvency law [may][should]:

(a) Permit the approval of a [single][joint] reorganization plan for two or more members of an enterprise group that are subject to insolvency proceedings; and

(b) Permit a reorganization plan proposed for two or more members of an enterprise group subject to insolvency proceedings to include, with consent, any other member of the enterprise group that is not subject to the insolvency proceedings. This paragraph does not affect the rights under applicable corporate rules of shareholders or creditors of that other member.

3. Notes on recommendations

40. Recommendation 24 (previously recommendations [23] and [24] of A/CN.9/WG.V/WP.76/Add.1) has been revised to reflect the concerns of the Working Group at its previous session,[6] in particular that a solvent entity could be included in the plan on a voluntary basis provided the shareholders and creditors of that solvent entity agreed in accordance with applicable corporate rules. A reference has also been included to the recommendations of the Legislative Guide relating to proposal, content, voting mechanisms and approval of a reorganization plan. That reference is intended to clarify that the considerations addressed in those recommendations, such as that the draft plan should recognize the interests and rights of different creditors, would also apply to reorganization plans in the group context. The Working Group may wish to consider whether those considerations should be more explicitly stated with reference to the enterprise group context, particularly since the creditors involved will be both different classes of creditors, as well as creditors of different members of the group, not simply different classes of creditors of a single debtor and since the same claim may be carried against several members of the group.

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[6] A/CN.9/622, paras. 74-75.

41. Paragraph (b) permits a reorganization plan to include a solvent member of the group, provided that the provisions of law applicable to such participation are met. Those might include, for example, that the shareholders and creditors of that entity have agreed to its inclusion in the plan. As drafted, the reference to another "member" of the group is limited to those members that could be subject to insolvency proceedings under the insolvency law (see above, explanation of "member of an enterprise group"). However, it might be desirable to provide that other types of entities that are part of the group, but not subject to the insolvency law, might also be included in a reorganization plan. In practice, for example, it may be required that those other entities be classified separately under the plan and an explanation of their relationship to the debtor(s) and the treatment they are to receive under the plan be included in the plan, in accordance with recommendations 143 and 144 of the Legislative Guide.

4. Additional questions on reorganization

42. Paragraph 48 of document A/CN.9/WG.V/WP.76/Add.1 notes that, with respect to reorganization, the Working Group may wish to consider other issues arising in the context of reorganization. These might include:

(a) The content of a reorganization plan and disclosure statement. The Working Group may wish to consider whether information additional to that specified in recommendations 143 and 144 would be required in the group context (see, for example, para. 41 above);

(b) Equitable treatment of creditors. Recommendation 1 (d) of the Legislative Guide requires an insolvency law to ensure equitable treatment of similarly situated creditors and recommendation 149 provides that all creditors and equity holders in a class should be offered the same treatment in a reorganization plan. With respect to a single debtor, those recommendations clearly apply as between the members of individual classes of creditors. In the group context, however, there may also be a need to achieve fairness more broadly between the creditors of the different group members involved in the plan. The Working Group may wish to consider whether, for example, there may be circumstances in which it would be appropriate to provide varying rates of return for creditors of different group members, without that treatment constituting a ground upon which the plan might be challenged in accordance with recommendations 152-153 of the Legislative Guide;

(c) The process of approval of the plan and achieving a balance between creditors of different group members subject to the plan, particularly with respect to defining the voting majorities required for approval. The Working Group may wish to consider whether those majorities should be the same as for approval of a reorganization plan for a single debtor, or whether different majority requirements that are specifically designed to facilitate approval in the group context might be appropriate;

(d) Treatment of related party claimants for voting purposes. Recommendations 127 and 145-149 of the Legislative Guide address voting mechanisms for approval of a plan and recommendation 184 addresses treatment of claims by related persons. Where an insolvency law restricts or removes the right of related party claimants to vote on approval of a plan, the Working Group may wish

to consider what impact that would or should have in the group context where those related parties were other members of the same group. In some groups, for example those with more internal than external creditors, such treatment might significantly limit the number of eligible creditors for voting purposes;

(e) Protections for minority creditors. Recommendations 152 and 153 of the Legislative Guide establish the conditions to be satisfied in order for a plan to be confirmed by the court or, in the case where confirmation is not required, the conditions against which any challenge can be assessed. The conditions required in each case are as set forth in paragraphs (a)-(e) of recommendation 152. The Working Group may wish to consider whether those conditions provide adequate protection for minority creditors in a group context; and

(f) Failure of implementation of the plan. Recommendations 158-159 of the Legislative Guide address the grounds for conversion of reorganization to liquidation and the consequences of a failure of implementation of a plan. The Working Group may wish to consider whether those recommendations are sufficient or appropriate in the group context or whether some other consequence of failure of implementation might be required where two or more members of the group are included in a single plan.