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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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IV. Addressing the insolvency of groups

1. Enterprise groups may be structured in ways that minimize the threat of insolvency to one or more group members, by entering into cross-guarantees, indemnities and similar types of arrangements. Where problems do arise, a parent company may seek to avoid the insolvency of any of its group members in order to preserve its reputation and maintain its credit in commercial and financial spheres by providing additional finance and agreeing to subordinate intra-group claims to other external liabilities.

2. However, if the complexity of an enterprise group's structure is disturbed by the onset of financial difficulty affecting one or more, or even all of the group members that leads to insolvency, problems arise simply because the group is constituted by members that are each recognized as having a separate legal personality and existence. Since, as noted above, the great majority of domestic insolvency and corporate laws do not address the insolvency of enterprise groups, even though group issues might be addressed outside the insolvency area in relation to accounting treatment, regulatory issues and taxation, the absence of legislative authority to the contrary or judicial discretion to intervene in insolvency means that each entity has to be separately considered and, if necessary, separately administered in insolvency. In certain situations, such as where the business activity of group members is closely integrated, that approach may not always achieve the best result for the business of the group as a whole, unless the individual proceedings can be closely coordinated.

3. Much of what already exists in domestic law regarding the insolvency of enterprise groups concentrates on the circumstances in which it might be appropriate to consolidate insolvency estates. What is lacking is more guidance on how the insolvency of enterprise groups should be considered more comprehensively and in particular, whether and in what circumstances enterprise groups should be treated differently from a single corporate entity.

4. A second key issue in the treatment of enterprise groups in insolvency is the degree to which the group is economically and organizationally integrated and how that level of integration might affect treatment of the group in insolvency and in particular, the extent to which a highly integrated group should be treated differently to a group where individual members retain a high degree of independence. In some cases, where for example the structure of a group is diverse, involving unrelated businesses and assets, the insolvency of one or more group members may not affect other members or the group as a whole and the insolvent members can be administered separately. In other cases, however, the insolvency of one group member may cause financial distress in other members or in the group as a whole, because of the group's integrated structure, with a high degree of interdependence and linked assets and debts between its different parts. In those circumstances, it might often be the case that the insolvency of several or many group members would lead inevitably to the insolvency of all members (the "domino effect") and there may be some advantage in judging the imminence of the insolvency by reference to the group situation as a whole or to coordinate the consideration with respect to multiple members.

A. Application and commencement

1. Joint application for commencement

5. As a general rule, insolvency laws respect the separate legal status of each enterprise group member and a separate application for commencement of insolvency proceedings is required to be made for each of those members that satisfy the standard for commencement of insolvency proceedings. There are some limited exceptions that allow a single application to be extended to other group members where, for example, all interested parties consent to the inclusion of more than one group member; the insolvency of one group member has the potential to affect other group members; the parties to the application are closely economically integrated, such as by intermingling of assets or a specified degree of control or ownership; or consideration of the group as a single entity has special legal relevance, especially in the context of reorganization plans.

6. The recommendations of the *Legislative Guide* concerning application for and commencement of insolvency proceedings would apply to debtors that are enterprise group members in the same manner as they apply to debtors that are individual commercial enterprises. Recommendations 15 and 16 establish the standards for debtor and creditor applications for commencement of insolvency proceedings and form the basis upon which an application could be made for each group member that satisfied those standards, including imminent insolvency in the case of an application by a debtor. In the enterprise group context, the insolvency of a parent enterprise may affect the financial stability of a subsidiary or the insolvency of a number of subsidiaries might affect the solvency of others, so that insolvency is imminent more widely across the group. That situation is likely to be covered by the terms of recommendation 15 if, at the time of the application with respect to the insolvent group members, it could be said of the other group members that they would be unable to pay their debts as they mature.

7. Permitting those group members that satisfy the commencement standard to make a joint application for commencement of insolvency proceedings would facilitate the consideration of those applications by the court, without affecting the separate identity of the applicants. Such a joint application might include, where permitted under the law and feasible in the circumstances, a single application covering all group members that satisfy the commencement standard or parallel applications made at the same time in respect of each of those members. The latter approach may be appropriate where the group members are not located in the same domestic jurisdiction and different courts have competence (as discussed below) or where other circumstances of the case, such as that there is a significant number of proceedings to be coordinated, suggest that a single application would not be practical. In both cases, the insolvency law should facilitate the court undertaking a coordinated consideration of whether the commencement standards with respect to the individual group members are satisfied, taking into account the group context where relevant.

(a) Joint application and procedural coordination

8. The making of a joint application for commencement of insolvency proceedings should be distinguished from what is referred to below as procedural

coordination. The purpose of permitting a joint application is to facilitate coordination of commencement considerations and potentially reduce costs. Commencement of multiple proceedings on the basis of a joint application should also facilitate coordination of those proceedings; the commencement date, and any other dates calculated by reference to that date, such as those relating to the suspect period, would be the same for each member. Permitting a joint application is not intended to predetermine how, if the proceedings commence, they will be administered and, in particular, whether they will be subject to procedural coordination. Nevertheless, a joint application for commencement might include an application for procedural coordination, as noted below, and might facilitate the court taking a decision on procedural coordination.

(b) Including a solvent group member in a joint application

9. An additional question that is often discussed in the group context is whether a solvent group member can be included in an application for commencement of insolvency proceedings with respect to other group members and if so, in what circumstances. Where a group member appears to be solvent but further investigation shows insolvency to be imminent, inclusion of that member in the application would be covered by recommendation 15 of the *Legislative Guide*, as noted above.

10. Where imminent insolvency is not an issue however, different approaches may be taken. Where a group is closely integrated, an insolvency law may permit an application for commencement to include group members that do not satisfy the commencement standard, on the basis that it is desirable in the interests of the group as a whole that those members be included in the proceedings. Factors relevant to determining whether the necessary degree of integration exists might include: that there is a relationship between the group members that is variously described, but involves, for example, a significant degree of interdependence or control; intermingling of assets; the fictitious nature of the group; unity of identity, reliance on management and financial support or other similar factors that need not necessarily arise from the legal relationship (such as parent-subsidiary) between the group members.

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

12. One of the problems with such an approach, however, is that the insolvency law will generally only cover those entities properly regarded as satisfying the standard for commencement of insolvency proceedings. A solvent group member may, however, be voluntarily included in a reorganization plan, where a commercial decision is taken by that member that it should participate in the plan (see below, A/CN.9/WG.V/WP.82/Add.3, paras. 54-55).

13. A joint application for commencement might also be permitted where all interested group members consent to the inclusion of one or more other members, whether they are insolvent or not, or all parties in interest, including creditors, so

consent. An insolvency law might also consider whether a group member not involved at the time of commencement of insolvency proceedings against other group members might later be joined in those proceedings if it is subsequently affected by those proceedings or it is determined that its joiner would be in the interests of the group as a whole.

(c) Persons permitted to make a joint application

14. Consistent with the approach of recommendation 14 of the *Legislative Guide*, an insolvency law may permit a joint application to be made by two or more enterprise group members that satisfy the commencement standard of the insolvency law and any creditor of two or more such members.

(d) Competent courts

15. A joint application for commencement with respect to two or more enterprise group members may raise issues of jurisdiction, even in the domestic context, if those group members are located in different places with different courts being competent to consider the respective applications. Some jurisdictions may allow those applications for commencement to be transferred to a single court where they can be centralized for consideration. Although that approach is desirable, it will ultimately be a question of whether domestic law would allow joint applications involving different courts to be treated in such a way. The fees payable and other associated issues arising out of a joint application for commencement may also need to be addressed.

16. Although the issue of which court is competent to consider a joint application for commencement where the subject group members are located in different jurisdictions might be addressed by law other than the insolvency law, it is desirable that the approach of recommendation 13 of the *Legislative Guide* be followed. This would require the insolvency law to clearly indicate or include a reference to the relevant law that establishes the court with jurisdiction over such an application. Adoption of that approach should make it clear to all relevant parties where and how such an application can be pursued.

(e) Notice of application

17. The recommendations of the *Legislative Guide* with respect to notification of an application for commencement of insolvency proceedings would apply to a joint application. A joint application by a creditor should be notified to the group members which are the subject of the application in accordance with recommendation 19 (a). Where group members make a joint application, notice would not be required until proceedings commenced on the basis of that application, in accordance with recommendation 22.

Recommendations

Purpose of legislative provisions

The purpose of provisions on joint application for commencement of insolvency proceedings with respect to two or more enterprise group members is:

(a) To facilitate coordinated consideration of those applications for commencement of insolvency proceedings;

(b) To enable the court to obtain information concerning the enterprise group that would facilitate determination of whether commencement should be ordered;

(c) To facilitate efficiency and reduce the costs associated with commencement of those insolvency proceedings; and

(d) To provide a mechanism for the court to assess whether procedural coordination of those insolvency proceedings might be appropriate.

Contents of legislative provisions

Joint application for commencement of insolvency proceedings

1. The insolvency law may specify that a joint application for commencement of insolvency proceedings may be made with respect to two or more enterprise group members. A joint application may be made by:

(a) Two or more enterprise group members, 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 enterprise group members provided that each of those members satisfies the commencement standard in recommendation 16 of the *Legislative Guide*.

Competent courts

2. The insolvency law should indicate that for the purposes of applying recommendation 13 of the *Legislative Guide* in the context of enterprise groups, the words “commencement and conduct of insolvency proceedings, including matters arising in the course of those proceedings” include joint applications for commencement of insolvency proceedings.

2. Procedural coordination

(a) Purpose of procedural coordination

18. Procedural coordination, as noted in the glossary, may refer to varying degrees of integration of multiple insolvency proceedings commenced with respect to enterprise group members. 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; assist the valuation of assets and the identification of creditors and others with legally recognized interests; and avoid duplication of effort. Although administered together, the assets and liabilities of each group

member involved in the procedural coordination remain separate and distinct, thus preserving the integrity of the individual enterprises of the group and the substantive rights of claimants. Accordingly, the effect of procedural coordination is limited to administrative aspects of the proceedings and does not touch upon substantive issues.

19. Multiple proceedings may be streamlined in various ways through an order for procedural coordination, facilitating sharing of information to obtain a more comprehensive picture of the situation of the various debtors; combining of hearings and meetings, including joint meetings of creditors; compiling of a single list of creditors and other parties in interest for the provision of notice and coordination of the provision of notice; establishment of joint deadlines; agreement on a joint claims procedure and coordinated sale of assets; and the holding of a single creditor committee or coordination among creditor committees. It may also be facilitated by appointment of a single insolvency representative to administer the insolvency proceedings or facilitate coordination between insolvency representatives where two or more are appointed (see below, A/CN.9/WG.V/WP.82/Add.3, paras. 42-46) and may involve cooperation between two or more courts or, in the domestic context, administration of the proceedings concerning group members in a single court.

20. Various factors might be relevant to considering whether procedural coordination is appropriate in a particular case. These may relate, for example, to information substantiating the existence of the group and identifying the linkages between group members and the position in the group of each member covered by the application, particularly where one of them was the controlling entity or parent. Although the provision of such detail might be difficult where creditors are permitted to apply for procedural coordination, the essence of the application is that the debtors are group members and the court would generally need to be satisfied as to that relationship when determining whether proceedings should commence.

21. With respect to creditor participation, the interests of creditors of the different entities have the potential to diverge and it is unlikely that those interests could be represented in a single committee. It may be the case, however, that in cases of procedural coordination involving many group members, establishing a separate committee for the creditors of each member might prove to be extremely costly and inefficient for administration of the proceedings. For that reason, the courts in some States have the discretion not to establish a creditor committee for each separate entity in appropriate circumstances. Accordingly, the general principle may be that it is desirable that the insolvency law permit a single creditor committee to be established in suitable cases.

(b) Timing of application and persons permitted to apply

22. The benefits to be derived from procedural coordination may be apparent at the time an application for commencement is made or may arise after proceedings have commenced. In either case, it is desirable that the court be given the discretion to consider whether the various proceedings should be procedurally coordinated. The court may consider whether to order procedural coordination on its own initiative, or in response to an application from authorized parties, such as any group member subject to insolvency proceedings, the insolvency representative of a member, who would generally possess the information most relevant for making such an application, or a creditor. In the case of creditors, it may be both desirable

and practical to limit a creditor application to those group members of which it is a creditor, since a creditor is generally only likely to have relevant information with respect to those entities.

(c) Competent courts

23. Procedural coordination may also raise the issues of jurisdiction noted above with respect to joint applications for commencement (see paras. 15-16 above), where different courts have competence over the various group members subject to insolvency proceedings. In jurisdictions where those issues arise, they would generally be determined by reference to domestic procedural law. In some States, different proceedings may be consolidated or transferred to an appropriate court, for example, the court with competence to administer insolvency proceedings with respect to the parent of a group. A range of other criteria, such as priority of filing, size of indebtedness or centre of control, might also be chosen to establish the prevailing competence of one court in the domestic setting. A key element of consolidating or transferring proceedings to a single court would be establishing communication between the courts involved. Creditors of different group members might also be located in different places, raising issues of representation and the location in which creditor committees would meet or be constituted.

24. Although these issues might be addressed by law other than the insolvency law, it is desirable, as noted above with respect to joint applications (para. 16), that the approach of recommendation 13 of the *Legislative Guide* be followed. That would require the insolvency law to clearly indicate or include a reference to the relevant law that establishes the court with jurisdiction over an application for procedural coordination.

(d) Notice of applications and orders for procedural coordination

25. An application for procedural coordination may be subject to the same requirements for giving of notice as an application for commencement of proceedings under the *Legislative Guide*. When made at the same time as the application for commencement of proceedings, only an application for procedural coordination by creditors would require notice to be given to the relevant debtors. An application by group members should not require creditors to be notified.

26. When an application for procedural coordination is made subsequent to commencement of proceedings, the same considerations would generally apply, since procedural coordination does not affect the substantive rights of creditors.

27. When an order is made for procedural coordination, it may be desirable to provide that notice of that order be given to creditors, even though such an order is not intended to affect their substantive rights. It may be possible, however, to draw a distinction between orders for procedural coordination made at the time of the application for commencement of insolvency proceedings and those made subsequently. In the former case, specific notice may not be required, but relevant information could be included with the notice of commencement of proceedings. Where the order is made subsequent to commencement of proceedings, giving notice may be appropriate. This may be particularly important where the law makes provision, as noted above, for cases commenced in different jurisdictions to be transferred to, or administered by, a single jurisdiction and that transfer may affect

procedural aspects of the proceedings of interest to creditors, such as location of meetings of a creditor committee or the place for submission of claims.

28. Provision of notice to all creditors may be satisfied with collective notification, such as by notice in a particular legal publication, when domestic legislation so permitted and when appropriate for instance in case of a large number of creditors with very small claims. In addition to the information required by the recommendations of the *Legislative Guide* addressing provision of notice on commencement of proceedings, notice of an order for procedural coordination might include the terms of the order and information relevant to, for example, coordination of hearings and meetings, and arrangements to be made with respect to lending.

(e) Modifying or terminating an order for procedural coordination

29. Given that the purpose of procedural coordination is to promote administrative convenience and cost efficiency, an insolvency law may include provisions relating to modification or reversal of such an order to accommodate changed circumstances. Such an approach might be appropriate when, for example, a coordinated reorganization is not successful and the individual members should be liquidated separately. Reversal of such an order, although rarely required, should be possible as the initial order is not intended to affect substantive rights. As a safeguard, the insolvency law could provide that reversal or modification would be possible, provided it was without prejudice to actions taken or rights affected by the initial order.

Recommendations

Purpose of legislative provisions

The purpose of provisions on procedural coordination is:

(a) To facilitate coordination of insolvency proceedings with respect to two or more enterprise group members in the interests of creditors and debtors, while respecting the separate legal identity of each group member; and

(b) To promote procedural convenience and cost efficiency.

Contents of legislative provisions

Procedural coordination of two or more insolvency proceedings

3. The insolvency law should specify that:

(a) The court may order or authorize the administration of insolvency proceedings with respect to two or more enterprise group members to be coordinated for procedural purposes. The scope and extent of the procedural coordination should be specified by the court;

(b) Procedural coordination may involve some or all of the following: provision of notice, information sharing, coordination of hearings, negotiations, procedures for filing of claims, and cooperation of insolvency representatives;

(c) An application for procedural coordination may be made at the time of an application for commencement of those insolvency proceedings or at any subsequent time.

Parties permitted to apply for procedural coordination

4. The insolvency law should specify that an application for procedural coordination may be made by:[1]

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

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

(c) A creditor but only with respect to those enterprise group members of which it is a creditor.

Consideration of applications for procedural coordination

5. The insolvency law should specify that the court may take appropriate steps to facilitate coordinated consideration of an application for procedural coordination.

6. For the purposes of recommendation 5, appropriate steps might include: coordinated and joint hearings; sharing and disclosing information; […].

Modification or termination of procedural coordination

7. 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.

Competent courts

8. The insolvency law should indicate that for the purposes of applying recommendation 13 of the *Legislative Guide* to enterprise groups, the words "commencement and conduct of insolvency proceedings, including matters arising in the course of those proceedings" include applications and orders for procedural coordination.

Notice of procedural coordination

9. The insolvency law should establish requirements for giving notice with respect to applications and orders for procedural coordination and modification or termination of an order for procedural coordination, including the scope and extent of the order; to whom notice should be given; who is responsible for giving notice and the content of the notice.

[*A/CN.9/WG.V/WP.82 provides an introduction to enterprise groups; Add.2 addresses treatment of assets on commencement of insolvency proceedings*

[1] It is also a matter for domestic law to determine the power courts may have with respect to initiating procedural coordination of insolvency proceedings (see below, A/CN.9/WG.V/WP.82/Add.3, para. 24, with respect to court power to initiate).

(protection and preservation of the insolvency estate, use and disposal of assets, post-commencement finance), avoidance, and subordination; Add.3 addresses remedies (extension of liability, contribution orders and substantive consolidation), participants (single insolvency representative) and reorganization plans; and Add.4 addresses international issues.]