Is the future bright for enterprise groups in insolvency? –analysis of UNCITRAL’s new recommendations on the domestic aspects

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1. INTRODUCTION

In recent years, considerable degree of effort has been put into the development of global norms in the area of insolvency and the renovation of national laws in light of such global standards. These efforts are led by various leading international institutions, which developed legislative guides, principles or good practice standards in regard to various aspects of insolvency law. Most prominently, the UNCITRAL Legislative Guide on Insolvency Law 2004 was developed (and agreed upon) by representatives from a large number of countries. Within these harmonization efforts, the problem of enterprise groups has thus far been given only preliminary thought. The Legislative Guide had addressed the topic by giving a brief commentary, which essentially highlights the main difficulties pertaining to groups in insolvency. However, it refrained from providing recommendations regarding this topic.

International initiatives aimed at providing frameworks for cross-border insolvency are also usually lacking explicit consideration of the matter of enterprise groups. The EC Regulation on Insolvency Proceedings does not attempt to deal with the issue of groups. Similarly, the

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1 This article is based on a paper presented at INSOL International Annual Conference in Shanghai (14-16 September, 2008) (but was significantly updated since). The author is grateful for helpful comments of colleagues in attendance at the Shanghai meeting and for the financial support of the British Academy small research grant.


3 Often the term ‘corporate group’ is being used. See n 10 on the meaning of the terms.

4 See UNCITRAL Legislative Guide (n 2), Part two, chapter V, Paras. 82-92.

UNCITRAL Model Law on Cross-Border Insolvency\(^7\) deals with single debtors, not with groups. An exception is the ALI Principles of Cooperation\(^8\) which although bounding their scope to a limited number of legal issues, do explicitly provide a couple of principles addressing the matter.\(^9\)

This neglect of enterprise groups does not seem to result from a lack of appreciation on the part of the above international bodies of the importance of the phenomenon. Rather, the matter has been considered to be particularly complex. Therefore, including it within a project aimed at devising a basic comprehensive cross-border insolvency model or a wide-ranging guide for insolvency law could have impeded the success of the whole endeavour. Undoubtedly, issues pertaining to the operation and default of enterprise groups deserve attention. The phenomenon of enterprise groups is quite a common one.\(^10\) Insolvency of an enterprise group is one aspect of this phenomenon that should be dealt with. However, dealing with enterprise groups involves a major conflict as recognition of the group may interfere with company law fundamentals—corporate separate personality and limited liability.\(^11\) Attempts to deal with issues pertaining to these notions via another area of the law,

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\(^6\) As explicitly indicated in the Report Virgos/Schmit (1996), Para. 76 (the Report has been recognized as the unofficial guide for interpretation of the EC Regulation). As the European Commission is required to report on the EC Regulation by 1 June 2012 and, if necessary, to produce proposals for its adaptation it may be that the issue will be addressed within this process.


\(^8\) The American Law Institute, Transnational Insolvency: Cooperation among the NAFTA Countries [2003].


\(^10\) It can be in the format of the traditional parent-subsidiary relationship or entities linked by contract. The group may comprise of companies or other forms of businesses. The new recommendations of UNCITRAL (on which the paper will further elaborate in the proceeding sections) propose a rather broad meaning to the term “enterprise group” referring to: “two or more enterprises that are interconnected by control or significant ownership” (see Pre-release (21 July 2010) of Part Three of the Legislative Guide: Treatment of Enterprise Groups, available at: <http://www.uncitral.org/pdf/english/texts/insolven/pre-leg-guide-part-three.pdf> [accessed: April 2011] [hereinafter: Part III of the Guide], Introduction, Para 4(a). “Enterprise” includes any entity regardless of its legal form (yet one which is subject to insolvency laws), and “control” refers to the capacity to determine, directly or indirectly, the operating and financial policies of an enterprise (see id, Para 4(b) and (c)); see further on the matter of defining enterprise groups in Mevorach (n 9), 15-31).

\(^11\) ‘Separate personality’ suggests that each company is a legal person distinct from its shareholders. The concept of ‘limited liability’ suggests that the company’s shareholders are not liable to the losses and debts of the company. In a group scenario this means that the assets of the entire enterprise are not available for liabilities incurred by one part of that enterprise. Similarly in regard to contractual linkages creating a group enterprise, contract law assumes an arm’s length relationship between independent entities of equal bargaining. In addition, contracts between the controlling entity and other network members may include provisions to exclude the ‘parent’ liability (see G Teubner “The many-headed Hydra: networks as higher order
in this context the law of insolvency, may be particularly problematic. Additionally, international bodies attempting to devise guidelines or best practices as standards usually base their suggestions on practice exercised on national levels. Yet, the group problem is often neglected in national regimes as well,12 in particular comprehensive regulation of groups in insolvency is generally lacking.

Bearing this in mind, the work of UNCITRAL Working Group V,13 which has begun confronting the matter in December 200614 (and has recently finalised its work),15 is an important and ambitious endeavour. This paper aims to examine some of the key new recommendations which the Working Group has proposed. In this respect the paper focuses on core insolvency law measures pertaining to enterprise groups (and will not discuss issues of international insolvency in regard to groups16). In particular it examines measures for consolidating or coordinating insolvency proceedings against group members. Section Two provides the background on the work of the Working Group, the scope of its task, and the key issues on which it has been focusing. Section Three considers the conceptual context to the deliberations, examining the scope of the concept of the corporate form and the extent to which insolvency measures recognizing the group may interfere with this notion. Section Four examines several key recommendations in regard to consolidation and coordination of insolvency proceedings against group members.17 Section Five considers the stand of the Working Group in regard to additional insolvency measures (for enterprise groups in insolvency) for dealing with group liability. The Conclusion provides some additional observations.

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12 There are exceptions. See e.g. the German Konzernrecht: para.291 et seq of the Aktiengesetz (Stock Corporation Act) 1965 (reproduced in English in KJ Hopt (ed.) Groups of Companies in European Laws, Legal and Economic Analyses on Multinational Enterprises, Vol. II (Berlin/New York 1982) 265-295) which deals with governance aspects of corporate groups explicitly in legislation.

13 U.N. Comm’n on Int’l Trade Law (UNCITRAL), Working Group V (Insolvency Law) [hereinafter: the Working Group]. The author is an adviser to the UK delegation in the deliberation of the Working Group. The views expressed in this study in regard to the work of Working Group V, however, are those of the author and do not necessarily reflect those of the UK delegation or of the Working Group.

14 At its thirty-first session.

15 See Section Two.

16 See Section Two in regard to the way the Working Group divided its discussions between the domestic and the international aspects pertaining to the topic of enterprise groups in insolvency, and see I. Mevorach, “Towards a Consensus on the Treatment of Multinational Enterprise Groups in Insolvency” (2010) 18 Cardozo J. of Int’l & Comp. L. 359 for a critical analysis of the recommendations on the international aspects.

17 The paper primarily refers to the new recommendations in Part III of the Guide (n 10). It also refers to various previous working papers and reports of the Working Group’s deliberations where relevant (available at: http://www.uncitral.org/uncitral/en/commission/working_groups/5Insolvency.html (last viewed 30 April 2011).
2. THE CONTEXT OF THE WORKING GROUP DELIBERATIONS

Notwithstanding the perceived difficulties in tackling the issue of enterprise groups in insolvency as explained above, UNCITRAL in 2006 has taken the view that further work of the Working Group would mainly focus on this topic. After the Legislative Guide has been finalised,¹⁸ as well as the Model Law¹⁹ (the latter being already adopted by a number of countries²⁰), a number of proposals were put before the Commission in regard to possible future work in the area of insolvency law, among which was the issue of the treatment of corporate groups in insolvency.²¹ The Commission has discussed the proposals at its thirty-eight session (2005),²² and considered it to be beneficial if an international colloquium will be held before a final decision will be taken on the scope of the further tasks for the Working Group. Following the colloquium in which the issue of corporate groups was one of the issues under consideration the Commission agreed that the topic of corporate groups in insolvency²³ was sufficiently developed to be referred to the Working Group for considerations in 2006.²⁴ In this regard it was acknowledged that undertaking further work on the topic would build upon and complement the work already completed by the Commission (in the Legislative Guide and the Model Law), yet the Working Group was given flexibility to make proposals to the Commission in regard to the scope of its work and the form it should

¹⁸ See n 2.
¹⁹ See n 7.
²⁰ Eighteen countries have so far enacted legislation based on the UNCITRAL Model Law, according to information contained in UNCITRAL Website (http://www.uncitral.org/uncitral/en/uncitral_texts/insolvency/1997Model_status.html) (last viewed 30 April 2011).
²¹ The other topics proposed for the Working Group’s future work were cross-border protocols in transnational cases, post-commencement finance in international reorganizations, directors’ and officers’ responsibilities and liabilities in insolvency and pre-insolvency cases, and commercial fraud and insolvency (see A/CN.9/582 and Add.1-7).
²² Preference was expressed at this stage to the topics of corporate groups, cross-border protocols and post-commencement financing (see Official Records of the General Assembly, Sixtieth Session, Supplement No.17 (A/60/17), Para. 210; see also U.N. Comm’n on Int’l Trade Law (UNCITRAL), Annotated provisional agenda for the Thirty-sixth session of Working Group V (Insolvency Law), A/CN.9/WG.V/WP.84 [hereinafter: WP.84], Paras. 5-15).
²³ The term ‘corporate group’ was originally used by the Working Group when it commenced its deliberations on the topic, yet later it suggested to replace it with the term “enterprise group” (see n 10).
²⁴ It was also agreed that the issue of post-commencement finance should initially be considered as a component of the work to be undertaken on insolvency of corporate groups, and that initial work to compile practical experience with respect to negotiating and using cross-border insolvency protocols should be facilitated informally through consultation with judges and insolvency practitioners (see WP.84, n 22, Para. 9).
take. The Working Group has held eight meetings on the topic of enterprise groups and has finalised its work on the matter in its 39th session in New York.

From the outset the Secretariat of the Working Group divided the matter under consideration into two broad topics- the ‘domestic issues’ and the ‘international issues’ pertaining to enterprise groups in insolvency. Accordingly, the Secretariat has initially provided notes to be the basis of the initial discussions of the Working Group which contained material on both topics. It should be noted, though, that as the initiative is considered ‘from the top’, by an international body, the entire product will be ‘international’. The idea is that reforms in national laws may then take place in light of the international standards which UNCITRAL will devise. In other words, it is an attempt at a degree of harmonization of insolvency laws (in the particular area in issue). Additionally, any measures which may be proposed for adoption within national regimes, even if primarily directed at domestic groups, will also serve multinational groups, if the latter’s insolvency (the whole or the part of the multinational group’s insolvency) ends up being handled in a jurisdiction which has adopted any of the proposed measures. In any case, clearly the division implies distinguishing between those core insolvency matters pertaining to groups (which may apply to domestic or multinational groups), and issues of private international law and cooperation which necessarily involves multinational groups. In the first four sessions the Working Group mainly focused on the domestic issues. In these sessions draft recommendations on matters pertaining to enterprise groups in insolvency have been provided for active discussion by the Working Group. The Working Group continued to discuss and refine the draft

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25 See WP.84 (n 22), Paras. 8-9. In this regard, it has been suggested by the Working Group that the possible outcome of that work might be in the form of legislative recommendations supported by a discussion of the underlying policy considerations (see U.N. Comm’n on Int’l Trade Law (UNCITRAL), UNCITRAL Report of Working Group V (Insolvency Law) on the work of its Thirty-first session, 8 January 2007, A/CN.9/618 [hereinafter: Report, Thirty-first session], Paras. 69 and 70. Indeed, the Working Group has decided that the outcome of its work on the topic of enterprise groups in insolvency will form Part III of the Legislative Guide (see U.N. Comm’n on Int’l Trade Law (UNCITRAL), Report of Working Group V (Insolvency Law) on the work of its Thirty-fifth session (Vienna, 17-21 November 2008), A/CN.9/666 [hereinafter: Report, Thirty-fifth session], Para. 111).


28 The term enterprise groups referred to by the Working Group (see n 10) is not confined to domestic groups.

29 See n 26.
recommendations in the following sessions. As aforementioned, this paper will focus on the domestic issues.

3. HANDLING ENTERPRISE GROUPS’ INSOLVENCIES: GOALS AND LIMITATIONS

Issues of enterprise groups in insolvency bring together insolvency law considerations as well as fundamental concepts of company law. On the one hand, measures taken in the event of insolvency should promote the goals of insolvency law. Generally, insolvency laws will be aimed at enhancing wealth maximization (post commencement of the insolvency proceedings), respect pre-entitlements of creditors and promote certainty, as well as consider wider goals, in particular equitable treatment of creditors, procedural fairness and facilitation of rescues. The promotion of these goals may require to have regard to the group as the relevant body or give effect to inter-connections among group members, thus to an extent disregarding the legal separateness among the group members. For example, a profitable rescue plan may need to encompass all the group entities rather than handle their insolvency on an entirely separate basis. On the other hand, regard should be given to the effect taking such an approach may have on the concept of the corporate form. Indeed, UNCITRAL in its fortieth session (2007) expressed concerns with respect to those components of the work of the Working Group which may have effect on the separate identity of the individual members of the group.

3.1 Entity law Vs. Enterprise law in theory and practice

The quest for the appropriate framework for assessing measures for enterprise groups in insolvency may therefore begin by outlining the scope of the notion of the corporate form. The more the notion is normatively desirable, resting on sound theoretical basis, and is practically widely accepted among jurisdictions, even in the group scenario, the more caution will be required in applying measures which may defeat this notion in the context of insolvency.

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30 While also devoting considerable time to the international aspects.
31 See a list of objectives delineated by the Legislative Guide (n 2, Part One). The list is comprised of nine such objectives (along the lines of the above concepts), yet without prescribing the details of particular ways of pursuing the tasks and the ways to balance between goals.
Generally, legal systems tend to adhere to the concept of the corporate form permitting separate personality and limited liability to be the default rules for companies even in respect to the relationship between companies and their ‘sisters’ or ‘parents’ in a group context. The English regime may represent a strict position in this respect, firmly wedded to the corporate separateness notion in respect to any combination in which the company may appear; whether it is a ‘one-man company’ (controlled and managed by the same individual), a private or public company or companies in a group. But respect to the corporate form is a widespread approach. Especially, the concept of limited liability is strongly grounded in legal systems. Ignoring the corporate form in this context is rare and restricted, as is apparent from findings of comparative study conducted by the OECD. Even what is regarded as the most advanced corporate group law, the German Stock Corporations Act 1965, which provides in legislation that parent companies will be liable for losses of their subsidiaries if they formalised an enterprise relationship, or otherwise dominated a subsidiary, seeks to preserve the subsidiary as a separate enterprise. It has also been observed that in practice it is getting closer to notions of common law systems imposing liability on parent companies in cases of wrongful acts rather than mere structural supremacy over a subsidiary.

The problem, however, is that the use of the group structure presents opportunities for manipulating the corporate form, evading regulations and responsibilities. For example, annual reports, balance sheets and profit and loss statements can be manipulated, by concealing losses using intra-group transactions designed to create profits. Avoidance of taxation may also be a particular problem in the group context, where profits and losses can

36 See PT Muchlinski, Multinational Enterprise and the Law (Oxford University Press, 2007), 318.
be manipulated by transfer pricing and other intra group transactions,\(^{39}\) as well as avoiding various prohibitions and regulations such as antitrust and monopoly.\(^ {40}\) The group business form may be used to avoid liability, for instance where those running the group strategically form subsidiaries so that hazardous activities will be segregated and resulting liabilities will be avoided.\(^ {41}\) The group may also be deprived of legal rights or parties dealing with it evade duties to the group if no effect is given to the inter-relations among its members. For instance, an employee of a parent company who has agreed to a restraint of trade provision (i.e., prohibiting the employee from working in a competitive business) may move on to work for a different company in direct competition with the parent’s subsidiaries and invoke separate personality concepts to claim he did not breach the agreement with the parent company.\(^ {42}\)

In other words, although the enterprise group is comprised of separate entities there may be close relationship among them and the group as a whole may be integrated and operate a single business.\(^ {43}\) Giving no effect to this economic reality may be detrimental either to the group or to parties dealing with it or the general public, depending on the circumstances and the particular area of the law and its objectives.

The tension between legal form and the economic reality of groups underlies the debate between entity law proponents and those invoking enterprise principles for groups. Entity law represents the traditional thinking, deeming the separate company as the main player, respecting the distinct corporate personality of the corporation and the limited liability of its shareholders. ‘Enterprise law’ suggests that in certain circumstances the enterprise may be regarded as the relevant entity or effect will be given to the relationship among group members.\(^ {44}\) Here a ‘new’ entity is recognized to an extent, based on economic facts rather than on legal incorporation.\(^ {45}\) Enterprise theory also addresses the relationship between entities linked by contract. It applies ‘relational law’ to any type of group comprised of distinct entities where the group operated in terms of economic realities as a unified business.

\(^{39}\) Id., 360, 366.

\(^{40}\) Id., 367.

\(^{41}\) Id., 360, 364.

\(^{42}\) See the English case, Beckett Investment Management Group Ltd v Hall [2007] EWCA Civ 613.

\(^{43}\) Of course, there may be different types of enterprise groups as this business phenomenon is immensely diverse, and certain groups may operate as pure conglomerates with autonomous subsidiaries and no significant inter-links among the members (see Hadden, n 38, 344-356; on types of multinational enterprise groups see Mevorach, n 9, 15-22).


Relational law as the basis of enterprise principles thus rests on status and relationship rather than on the party’s participation in the transaction or any contract, assumption, ratification, or other consensual act.\(^{46}\)

Entity law rests on strong economic grounds. Critically, the limited liability facility has been found crucial in encouraging commerce and reducing various transaction costs. It decreases the need for shareholders to monitor the managers of companies in which they invest because the financial consequences of company failure are limited; it provides incentives for managers to act efficiently and in the interests of shareholders, as well as enhance market efficiency as it promotes free transfer of shares, due to the fact that under limited liability the price at which shares are traded does not depend upon an evaluation of the wealth of other shareholders; it permits efficient diversification by shareholders, which in turn allows shareholders to reduce their individual risk and it facilitates optimal investment decisions by managers who can invest in projects with positive net present values without exposing shareholders to the risk of losing their personal wealth.\(^{47}\)

These advantages may be less significant, though, in the group context, especially in case of closely held subsidiaries where the parent is the sole or largely the sole shareholder. Here the parent company is not an absentee owner investing in various companies. It is also likely to monitor the affairs of the subsidiary anyhow.\(^{48}\) Yet, the fact that entity law enables ‘asset partitioning’ among the company and its shareholders, or the members in a group (and each entity is liable to its own debts) means that creditors do not need to monitor the creditworthiness of other group members when they extend credit to a particular entity.\(^{49}\) This is quite a strong argument of entity law also in the group context.

On the other hand, economic efficiency stops short in giving sufficient responses to the problem of manipulations of limited liability (i.e. the externalization of losses, shifting business risks to creditors, especially when insolvency is expected).\(^{50}\) In the group context there are greater opportunities for such manipulations. Therefore, although limited liability is

\(^{46}\) Blumberg et al (n 11) Vol. 1, s. 6.02.


\(^{50}\) See e.g. D Goddard “Corporate Personality- Limited Recourse and its Limits” in R Grantham and C Rickett (eds) \textit{Corporate Personality in the 20th Century} (Hart Publishing Oxford 1998), 11.
well grounded and widely accepted there should be exceptions to the rule. Indeed, legal regimes normally set such exceptions, allowing the lifting of the corporate veil in various ways and different circumstances. However, while recognizing that limited liability should be limited, legal systems tend to be obscure as to the instances where this concept might be overridden, especially in common law systems using vague concepts such as ‘lifting the veil’. Specifically, the degree to which any exceptions to limited liability can be grounded on group considerations (the inter-relations among the group components or the extent to which a parent controlled a subsidiary) is largely uncertain and varies among legal systems. In the UK for example, the ‘single economic unit’ argument, according to which the veil may be lifted if there were significant connections between the group members has been generally rejected. In other jurisdictions there is occasional regard to the inter-relationship among the group members in determining on issues of liability.

Enterprise law will be particularly constructive if it is utilized in shaping the circumstances where limited liability should be restricted in order to combat group opportunism. It should not be the rule that the group controller is liable to the debts of its subsidiary (rather the corporate separateness should be respected) but enterprise law (and its emphasis on economic realities) can clarify the exceptions arising from the peculiarities involved with group operations.

Furthermore, the group may be recognized for purposes other than imposing liability. Here, where the policy concerns underlying the doctrine of limited liability are absent recognizing the group will be less intrusive to entity law. On the other hand, it may better fit with economic realities and promote the objectives of the particular area of the law under concern. Indeed, legal regimes tend to recognize the group in more ease, where limited liability is not at stake, for example in the area of taxation and for financial disclosure purposes. Thus, for example, enterprise groups are usually obliged to prepare consolidated annual reports to be presented to the public. This gives a more accurate picture of the financial state of the enterprise and therefore it promotes the goals of that area of the law, bearing in mind the inter-connections among the entities. At the same time it does not defeat limited liability.

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52 See e.g. the US approach in Blumberg et al (n 11), chs. 12, 26-27, 59-60, 68-69. See also on the use of statutory provisions in the context of group liability in Section Five.
53 See PI Blumberg, “The Transformation of Modern Corporation Law: The Law of Corporate Groups” (2005) 37 Conn. L. Rev. 605, 611. In general, cases apparently invading corporate separate personality are often not concerned with limited liability (see Goddard, n 50, 62).
54 Though such legislations are often complex and sometimes uncertain of application (see Hadden, n 38, 366).
3.2 Promoting insolvency objectives without defeating the merits of corporate separateness

Both entity and enterprise law should therefore be acknowledged when dealing with enterprise groups in insolvency. If recognizing the group in the context of insolvency would interfere with limited liability and asset partitioning, the presumption should be against group recognition. The promotion of insolvency goals should not undermine the limited liability concept, unless enterprise law points out to a factual circumstance where limited liability and ‘asset partitioning’ were not kept in terms of economic reality (where there was no partitioning in the ordinary course of business). In addition, enterprise law may identify a situation where there was actual exploitation of limited liability in the insolvency context in order to harm creditors. In these cases, there is no justification to adhere to limited liability in the event of insolvency (at least not to the fullest extent). Where recognizing the group does not involve imposing liability there should be more inclination towards acceptance of the group as the relevant body (applying enterprise law measures) if it promotes insolvency goals and fits with economic reality of the way the group operated. In any case, the enterprise measure chosen for the pursuit of insolvency goals should be the one the least harmful to limited liability and asset partitioning. In other words, if there are alternative ‘enterprise law based measures’ for achieving the same policy objectives; the one which is less interventionist (in terms of respect of the corporate form) should be preferred.

Broadly speaking, it is suggested that when we consider the treatment of groups in insolvency (applying such measures that seek to unify entities in the course of insolvency or give effect to the inter-relationships among the group members) we should ask two questions: one is whether the measure we consider promotes insolvency goals. But also at the same time- does it unduly interfere with entity law- defeating limited liability and asset partitioning. With this in mind the paper will proceed to examine some of the draft recommendations for treating enterprise groups in insolvency currently considered by the Working Group.

4. MEASURES FOR CONSOLIDATING OR COORDINATING INSOLVENCY PROCEEDINGS AGAINST GROUP MEMBERS

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In considering the ‘domestic issues’,\textsuperscript{55} the Working Group devoted considerable effort at examining measures for handling insolvency proceedings against group members jointly or with a degree of coordination.

In this respect, two main types of consolidation measures may be generally recognized (in those regimes allowing for such measures) - procedural and substantive consolidation. Procedural consolidation is also known as joint administration or procedural coordination (the latter term is the one used by UNCITRAL and will be referred to in this paper). It is a manner for unifying insolvency proceedings against separate entities for administrative purposes. Substantive consolidation (also known as pooling orders) is a measure for merging assets and debts, as will be elaborated below.

In the rest of this section it is attempted to highlight the essence of several key recommendations in regard to coordination and consolidation measures (and related matters), and to consider their desirability in light of the concerns raised in Section Three above. Therefore, the order in which the recommendations appear in the new part III of the Legislative Guide is not necessarily followed here. In addition, the section will not discuss all the various recommendations on these issues.

4.1 Coordination of the insolvency proceedings against group members and achievement of unified solutions for the group business

Coordinating the insolvency proceedings of group members for procedural purposes can be achieved in various ways, perhaps most effectively where all proceedings are joined into a single process (following a joint application for commencement of insolvency proceedings). This may then result with the same court and the same insolvency representative handling the proceedings. The Working Group was in favour of adopting such tools in insolvency laws. Thus, it is now proposed by UNCITRAL that insolvency laws allow filing a joint application for commencement of insolvency proceedings against several group members.\textsuperscript{56} At the same time of an application for commencement of insolvency proceedings or at a subsequent time,

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\textsuperscript{55} See Section Two.
\textsuperscript{56} See Part III of the Legislative Guide (n 10), recommendation 199. Recommendation 200 specifies the persons who could make such a joint application (enterprise group members each of which satisfies the applicable commencement standard as provided elsewhere in the Legislative Guide (n 2), or a creditor of the group members (of each of those members included in the application)).
it should be possible to apply for procedural coordination. A procedural coordination order may then be provided. This will be a decision of the court based on the application for procedural coordination, and the procedural coordination “may involve, for example, appointment of a single or the same insolvency representative; establishment of a single creditor committee; cooperation between the courts, including coordination of hearings; cooperation between insolvency representatives, including information sharing and coordination of negotiations; joint provision of notice; coordination between creditor committees; coordination of procedures for submission and verification of claims; and coordination of avoidance proceedings.” Another recommendation deals with the issue of conflict of interest which may arise when appointing a single representative to several group members, and provides that insolvency laws should specify measures to address such problems. These may include the appointment of one or more additional insolvency representatives.

However, such appointment may be made even in the lack of a procedural coordination order. Additionally, a degree of coordination of the proceedings for administrative purposes could also be achieved even if a single insolvency representative is not appointed or separate proceedings take place. The Working Group suggests having such flexibility in the law. It suggests that even if there is no order for the coordination of the proceedings, or a single representative appointed, the law may specify that the relevant representatives appointed in the insolvency proceedings of the group members will cooperate in the course of those separate processes “to the maximum extent possible.”

Cooperation among insolvency representatives appointed in the insolvency proceedings of group members should also be sought in the scenario where procedural coordination has been

57 Part III of the Legislative Guide (n 10), recommendations 202 and 205. Note that the recommendations suggest that once proceedings had commenced against two or more members, an application for procedural consolidation might be made by a creditor of a group member subject to insolvency proceedings. The creditor does not have to be a creditor of all group members in regard to which procedural consolidation is being requested (id, recommendation 206(c)). Otherwise, the representative of an enterprise group member, or enterprise group members subject to an application for commencement of insolvency proceedings or subject to insolvency proceedings, may make such an application (id., recommendation 206 (a) and (b)). It is further recommended that the law may permit the court to order procedural coordination on its own initiative (id, recommendation 203).

58 Id., recommendation 204.

59 Id., recommendation 233.

60 Id., recommendation 234 and 236 (recommendation 236 delineates forms of cooperation).
ordered. In such circumstances, if a single representative was not appointed, clearly cooperation among the representatives is essential in achieving procedural coordination.

Another recommendation suggests allowing a coordinated reorganization plan to be devised in regard to several group members. The plan may include solvent members which decide to participate in the plan. Indeed, the possibility to devise such group-wide solutions is one of the main aims of administrative coordination of insolvency proceedings of group members.

This brings us to the policy issue, namely the question of the desirability of administrative coordination (whether under formal procedural coordination order or via the other means for coordination explained above). Primarily, I suggested asking whether such coordination will promote insolvency goals.

It seems that first and foremost coordination of the proceedings can enhance wealth maximization- increasing assets value, reducing post-commencement costs of the handling of the insolvency processes and facilitating rescues. The unification of the proceedings for procedural purposes can save various costs, for instance in regard to obtaining information on the affiliates which may be relevant to other group members, or in preventing multiple hearings and filings on issues common to the group members under insolvency. It will also allow considerations of group-wide solutions for the group business, such as joint sales of assets, or unified reorganizations plans. Especially if the group is integrated such unified solutions may generate greater value for the benefit of the group stakeholders, as the firm as a whole is often worth more than the collection of its parts.

The second question is whether procedural coordination (or other variations aimed at coordinated administration) risks the benefits of entity law. It seems that there is no such risk here. In fact, limited liability does not seem to be at stake. Unification is for administrative

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61 Id., recommendation 235.
62 This will be an ordinary business decision taken by the solvent entity (see id., recommendations 237 and 238).
63 The purpose clause in regard to joint applications provides that the mechanism aims to facilitate coordinated consideration of applications for commencement of insolvency proceedings against several group members, to enable the court to obtain information concerning the enterprise group, to promote efficiency and reduce the costs and to provide a mechanism for the court to assess whether procedural coordination would be appropriate (see id., purpose clause preceding recommendation 199). The purpose of procedural coordination is to facilitate coordination of the administration of insolvency proceedings against group members (while respecting the separate legal entity) and promote cost-efficiency and a better return to creditors (id., purpose clause preceding recommendation 202).
64 In this respect, UNCITRAL also stresses the importance of post commencement financing in the group context (see id., recommendations 211-216).
65 See n 43 and accompanying text.
purposes only. The idea is to coordinate the proceedings jointly, while liabilities remain attached to the specific entity. The insolvency representative (even if it is the same representative appointed to all the relevant entities\textsuperscript{66}) is required to consider the interests of each entity separately. Voting and approving of a unified reorganization plan is to be conducted by the creditors of each entity on a separate basis.\textsuperscript{67} The group is recognized only for procedural purposes, in order to give effect to the economic reality and pursue insolvency goals.

It may be justified, however, to go somewhat further towards enterprise law. Taking ‘group considerations’ in construing solutions for the group business, even if initially rights of creditors towards the separate entity with which they were dealing are ‘sacrificed’, can achieve an overall fair and efficient solution. In this regard, where the group was integrated\textsuperscript{68} a unified plan, for example, could be beneficial to a wide set of stakeholders (when considered on a group scale) yet it might be rejected by certain entities. In such circumstances, there is merit in proceeding with a plan while safeguarding the rights of the dissenting creditors. Indeed, the Legislative guide in setting forth insolvency goals stresses that insolvency laws recognize existing creditor rights,\textsuperscript{69} yet it also directs insolvency laws to pursue wider goals including enabling reorganizations while considering the range of interests involved including the value of the business to society.\textsuperscript{70} The commentary to the recommendations mentions safeguards that could be implemented in such circumstances, drawing on measures for approving and confirming plans for single debtors.\textsuperscript{71} Further considerations can be made to any concrete indication regarding specific opportunities that the dissenting creditors would have had if the group member was administered on a separate basis and consequently any harm caused to the dissenting creditors as a result of the unified plan. This way, the enterprise law measure (the consideration of voting on a group level) is balanced with entity law concerns while a beneficial solution to the stakeholders of the group as a whole can be pursued.

In this respect, the Working Group had expressed a view that it should not be allowed to consider approval of a plan on a group basis and allow the majority of creditors of the

\textsuperscript{66} See n 59 and accompanying text.

\textsuperscript{67} See Part III of the Legislative Guide (n 10), Part II, F, Para. 148.

\textsuperscript{68} See n 43 and accompanying text.

\textsuperscript{69} The Legislative Guide (n 2), Part one, Ch. 1, Para. 13.

\textsuperscript{70} Id., Para. 6.

\textsuperscript{71} See recommendation 152 of the Legislative Guide (n 2); Part III of the Legislative Guide (n 10), Part II, F, Para. 149; see also WP.74/Add.1 (n 27), Para.22 explaining that insolvency laws may ensure that the unified plan is fair to the rejecting creditors in relation to their position relative to creditors of other group members.
majority of members to compel approval of a plan for all members,\(^72\) taking a strict view in regard to respect of the corporate form. Though, it seems that the commentary on the matter may leave some leeway to consider the consequences of rejection of a plan by particular group members.\(^73\)

4.2 Substantive consolidation

Substantive consolidation is a different matter altogether. Essentially, it involves the merging of the substance of the entities. Indeed, in the glossary to the new recommendations it is explained that substantive consolidation is “the treatment of the assets and liabilities of two or more enterprise group members as if they were part of a single insolvency estate”.\(^74\)

It can be argued, though, that substantive consolidation is also not concerned with limited liability, as it is not about imposing liability on a group member, rather it involves the mixing of assets and debts together which is as such a competition among the creditors, and not between the creditors of the company and the shareholders (the latter being protected by limited liability).\(^75\) Yet, certainly substantive consolidation interferes with the concept of ‘asset partitioning’.\(^76\) Substantive consolidation suggests ignoring this segregation. As a consequence, the transaction costs related to monitoring in financing of entities in groups may increase if parties act ‘in the shadow’ of a rule suggesting substantive consolidation for groups in insolvency. The case for caution in the application of substantive consolidation is hence well grounded. The presumption should be that the separation should be kept and that substantive consolidation will not be imposed, except where necessary for pursuing the goals of insolvency and where the corporate form was not kept or was exploited. Additionally, if


\(^{73}\) See n 71.

\(^{74}\) See Part III of the Legislative Guide (n 10), Introduction, Para 4(e). The other effects of the order are the termination of intra-group debts and claims and the treatment of other claims as if they were against a single estate (id., recommendation 222). It is also emphasized that, in so far as possible, security rights are respected under a substantive consolidation order (id., recommendation 225), as well as priorities established in the individual insolvency proceedings (id., recommendation 226; see also U.N. Comm’n on Int’l Trade Law (UNCITRAL), Working Group V (Insolvency Law), Thirty-sixth session, Legislative Guide on Insolvency Law, Part three: Treatment of enterprise groups in insolvency, Note by the Secretariat, 6 March 2009, A/CN.9/WG.V/WP.85, Para. 23 which notes the need to include the phrase “as far as possible” as there may be circumstances where the relative ranking of a claim may be altered as a result of the substantive consolidation).


\(^{76}\) See n 49 and accompanying text.
other mechanisms are available (capable of achieving the same goals) which are less interventionist (of entity law) these should be preferred.\textsuperscript{77}

Indeed, the Working Group took the view that substantive consolidation should be imposed only in pre-defined set of circumstances which are to be regarded as exceptions to the main rule- that of corporate separateness.\textsuperscript{78} The question is whether the exceptions delineated in the final recommendations make the right balance between the concerns regarding the corporate form (entity law) and insolvency goals (which may require the application of enterprise measures). The sub-sections below discuss exceptions which were considered by the Working Group (some of which were eventually embraced in the final recommendations).

4.2.1 The ‘entangled business’ scenario

The first scenario in which substantive consolidation might be imposed (according to the recommendation) is where the court is satisfied that the assets or liabilities of the enterprise group members are intermingled to a degree that ascertaining the actual ownership of assets or liabilities will involve disproportionate expense or delay.\textsuperscript{79} This would be the case if, for instance, assets have been transferred around the enterprise with no proper book keeping; intra-group claims are unascertainable, and so forth. The result is significant confusion as to which entity owes what to which creditor, or which entity is the true owner of which assets.\textsuperscript{80}

Will substantive consolidation in such circumstances promote insolvency goals? Certainly it will enhance wealth maximization as it saves the considerable costs involved in reconstructing the separate businesses. Especially if some sort of reorganization may be sought, wasting such amount of time and money on ascertaining claims and the real ownership over assets can be highly detrimental on the ability to have sufficient resources for the continuation of the business and impede the exercise of urgent measures. The ‘contents’ of all those entities which were intermingled to the extent envisaged may therefore be mixed.\textsuperscript{81}

\textsuperscript{77} See Section Three.
\textsuperscript{78} A specific recommendation explicitly states that insolvency laws should respect the separate legal identity of each group member (Part III of the Legislative Guide (n 10), recommendation 219).
\textsuperscript{79} See id., recommendation 220(a).
\textsuperscript{80} See further Part III of the Legislative Guide (n 10), Part II, D, Para. 113.
\textsuperscript{81} The commentary to the recommendations explain that the substantive consolidation order may extend to apparently solvent members whose affairs were closely intermingled with those of the insolvent group members (see id., Part II, D, Para. 111). The commentary also mentions the possibility to substantively consolidate group members, solvent or insolvent (and not necessarily intermingled to the extent envisaged by
Substantive consolidation in such circumstances does not excessively defeat entity law, as it imposes a pooling mechanism only where there was ‘a façade of asset partitioning’. That is, the evidence suggests that there was no partitioning as a matter of economic realities. It also fits with fairness in distribution. The intermingling between the entities in these scenarios resulted in a situation where all creditors in fact belonged to the group as a whole, and therefore a fair distribution means that all assets of the group should be available for distribution to all creditors. The claims subject to the substantive consolidation order cannot be ascertainable against a specific group member (with reasonable effort) and therefore it cannot be shown that a creditor could have gained more by remaining ‘attached’ to a particular entity. The possibility to exclude certain entities or certain creditors from the substantive consolidation in case their debts were ascertainable (applying partial substantive consolidation) further ensures that there is no ‘redistribution’ of rights.

4.2.2 Reliance

Another scenario which the Working Group had considered when deliberating on the issue of substantive consolidation was where creditors have relied on the group as a whole when they extended credit to any of the group entities (for instance, if the group presented itself as a single enterprise). Reliance of creditors is one of the factors which may be the basis for...
substantive consolidation, for example under the US substantive consolidation regime.\textsuperscript{86} However, the Working Group considered it to be too vague and subjective as a basis for substantive consolidation, and thus supported a proposal to omit this exception.\textsuperscript{87}

Indeed, when the focus is on creditors’ reliance and expectations, the result may vary among creditors, thus it might undermine the goal of certainty (in regard to rules in insolvency) as the circumstances where substantive consolidation will be applied may be considerably unpredictable.\textsuperscript{88} Additionally, in this case conducting the insolvency for the group as a whole as if it was one entity will not necessarily save costs (unless it is indicative of an intermingling scenario), but can increase returns to certain creditors which may belong to a relatively ‘weak’ entity. Here, though, there is redistribution of rights (unless there is an equal asset to liability ratio) on an arbitrary basis, and thus pre-insolvency entitlements are not adequately respected.\textsuperscript{89}

What is crucial, though, is to enable an adequate response to manipulation of the corporate form in the context of insolvency, and provide remedies for situations where there was actual misleading of creditors regarding the creditworthiness of the entity with whom they were dealing. It is implied from the working papers of the Working Group that in these situations there may be remedies (other than substantive consolidation) which could adequately deal with such scenarios.\textsuperscript{90}

4.2.3 Fraudulent schemes

The other scenario in which the Working Group is suggesting to impose substantive consolidation is where several group members were engaged in some fraudulent scheme or

\textsuperscript{86} See e.g. Soviero v Franklin National Bank 328 F. 2d. 446 (2\textsuperscript{nd} circ. 1964); Union Sav. Bank v. Augie/Restivo Baking Company (In re Augie/Restivo Baking Co) 860 F 2d 515 (2d Cir 1988); In re Owens Corning, 419 F.3d (3d Cir. 2005)).
\textsuperscript{87} See U.N. Comm’n on Int’l Trade Law (UNCITRAL), Report of Working Group V (Insolvency Law) on the work of its Thirty-fourth session (New York, 3-7 March 2008), A/CN.9/647 [hereinafter: Report, Thirty-fourth session], Para. 64. The exception was indeed omitted.
\textsuperscript{88} I Mevorach, “Appropriate treatment of corporate groups in insolvency- a universal view” [2006] EBOR, 187-188.
\textsuperscript{90} See Report, Thirty-fourth session (n 87), Para. 64. See also Section Five below on remedies for combating ‘group opportunism’.
activity with no legitimate business purpose.\textsuperscript{91} It is further explained in the commentary that the type of fraud contemplated is not fraud occurring in the daily operations of a company, but rather the total absence of a legitimate business purpose, for example where the debtor transfers substantially all of its assets to a newly formed entity so to hinder, delay and defraud its creditors.\textsuperscript{92}

Indeed, the Legislative Guide in discussing legal systems’ insolvency objectives stresses that insolvency laws address problems of fraud and favouritism that may arise in the context of financial distress.\textsuperscript{93} The idea is to ensure equitable treatment of creditors and promote commercial morality. Certainly, tackling fraud will enhance insolvency goals. Yet, remedies other than substantive consolidation may be more adequate in such circumstances (unless the activity contemplated involved intermingling of assets\textsuperscript{94}). As aforementioned, substantive consolidation contravenes the economic benefits of entity law.\textsuperscript{95} Yet, the fraudulent transactions could be attacked otherwise under relevant avoidance provisions.\textsuperscript{96} Reversing transactions would be less interventionist to entity law as it is directed to particular transactions, and it only deprives the creditors of the relevant entity (involved in the transaction) to the extent that they have benefited from a transaction outside the terms of the original bargain, because the transaction was, for example, fraudulent. Avoidance of transactions in such circumstances is also widely accepted outside the context of enterprise groups (and is applied in the context of intra-group transactions).\textsuperscript{97} Indeed, the exception to the recommendation on substantive consolidation which refers to fraudulent schemes requires that the court will be satisfied that substantive consolidation is required to rectify the scheme.\textsuperscript{98} This may mean that if another remedy is available to achieve that result it should generally be adopted.

5. CONTRIBUTION ORDERS? THE ENTITY- Vs. ENTERPRISE LAW CONFLICT AT ITS PEAK

\textsuperscript{91} See Part III of the Legislative Guide (n 10), recommendation 220(b).
\textsuperscript{92} See id., Part II, D, Para. 114.
\textsuperscript{93} The Legislative Guide (n 2), Part one, Ch. I, Para. 7.
\textsuperscript{94} See Section Four, 4.2.1.
\textsuperscript{95} See texts accompanying n 76-77, and Section Three.
\textsuperscript{96} See Legislative Guide (n 2), Part two, Recommendation 87(a).
\textsuperscript{97} See n 105 and accompanying text. For further analysis of the UNCITRAL’s recommendations on avoidance transactions in the group context see I. Mevorach, “Transaction Avoidance in Bankruptcy of Corporate Groups” (Forthcoming, (2011) European Corporate and Financial Law Review).
\textsuperscript{98} See Part III of the Legislative Guide (n 10), recommendation 220(b).
The Secretariat of the Working Group has provided various materials regarding available measures (in different legal regimes) for dealing with group opportunism in the insolvency context.99 These include fraudulent and wrongful trading type of provisions usually aimed at tackling fraud on creditors or excessive risk taking by managers in the vicinity of insolvency; contribution orders against related companies in circumstances where they should bear some responsibility to the financial situation of the company in liquidation; lifting the veil measures, allowing to extend liability to the debtor’s shareholders in exceptional circumstances; avoidance provisions for tackling vulnerable transactions such as fraudulent transactions, or transactions which give a preference to creditors or are undervalued and where entered into at a specified time prior to the commencement of insolvency proceedings; and subordination mechanisms, where the court may rearrange creditor priorities and defer a debt to that of other creditors.100 The Working Group had considered whether any such measures should be recommended for adoption as measures for addressing problems pertaining to enterprise groups in insolvency.101

In particular, it considered the issue of contribution orders as this was a remedy not addressed in previous deliberations of the Working Group (in formulating the Legislative Guide).102 The contribution order is also a measure ‘tailored made’ to groups in insolvency. It explicitly allows making a related company contribute funds to the insolvency estate of the company in

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99 Apart from substantive consolidation discussed above (see Section Four).
102 UNCITRAL Legislative Guide in considering the issue of subordination explains the scenarios where it might be applicable under different legal regimes (see UNCITRAL Legislative Guide (n 2), Part two, Ch. V, Paras. 48, 60 and 61, and Recommendation 184(c)). The issue of avoidance transactions is also dealt with in the Legislative Guide (see Legislative Guide, n 2, Part II, Recommendations 87-99). But see also n 105 and accompanying text in regard to the Working Group deliberations on these matters.
liquidation in circumstances of involvement or misconduct of the related company, where this will achieve just and equitable results.  

The Working Group eventually took the view that it is not required to adopt such a measure in its future recommendations. Should the need arise it will be possible to apply remedies already available in legal regimes, such as extension of liability and wrongful trading. Yet, the Working Group did not propose recommendations in regard to the circumstances where any such remedies, aimed at tackling group opportunism, should be applied. In this respect, it confined the deliberations to reference to the Legislative Guide recommendations on avoidance provisions while adding recommendations in regard to taking group consideration in avoiding intra-group transactions. It also refers to the Legislative Guide’s recommendation on subordination, although the Guide does not recommend the subordination of any particular types of claims under the insolvency law.

It might be that the Working Group has taken here a realistic approach, appreciating the fact that the conflict between the fundamental concepts of company law (underlying entity law) and the recognition of the group is at its peak when suggesting to impose liability on a group member for debts of another member. Thus, it may prove too difficult to reach a consensus on which remedies should be imposed in which circumstances. However, these issues should not be forsaken, and there is certainly room for future work on regional and international levels on these matters, further attempting at a degree of harmonization in this area. Not all national regimes have relevant effective remedies available (such as contribution orders or wrongful trading type of provisions applicable to parent companies). Even where these measures are available there is often ambiguity as to their application to groups. For example, the wrongful trading types of provisions are often primarily directed at managers’ liability, while laws tend to be obscure as to the circumstances when liability could be imposed on a parent company.

Avoidance provisions may not suffice in combating abuse within groups.

103 See New Zealand Companies Act 1993, ss. 271-272.
104 See Report, Thirty-third session (n 101), Para. 94.
105 See Legislative Guide (n 2), Part two, recommendation 87; Part III of the Legislative Guide (n 10), recommendations 217-218.
106 UNCITRAL Legislative Guide (n 2), Part two, Ch. V, Paras. 48, 60 and 61, and Recommendation 184(c). See also Recommendation 189(d) where the Guide notes that subordinated claims would rank after claims of ordinary unsecured creditors; Report, Thirty-third session (n 101), Para. 60.
107 See WP.82/Add.2 (n 100), Para. 44. Part III of the Legislative Guide provides additional commentary on subordination, but further recommendations were not developed (Part III of the Legislative Guide (n 10), Part II, C, Paras. 83-88; Report, Thirty-fifth session, n 25, Para. 80).
108 See e.g. the application of the ‘shadow director’ concept under the English wrongful trading regime (Hydrodan (Corby) Ltd. [1994] 2 BCLC 180).
as certain transactions or misbehaviour may not be covered by the terms of avoidance provisions. Explicit views by an international body in regard to particular remedies for dealing with group liability and the circumstances where these may be applied will also promote certainty and clarity as to the circumstances where substantive consolidation should be applied, and where other remedies are more adequate.

6. CONCLUSION

The paper focused on some of the key new recommendations proposed by UNCITRAL regarding the domestic issues pertaining to enterprise groups in insolvency. As aforementioned, the work on these issues has been recently finalized by the Working Group of UNCITRAL and the new recommendations will be included as part three of the UNCITRAL Legislative Guide on Insolvency Law. Thus, it remains to be seen what will be the uptake of these new standards by domestic policy makers. Crucially, a successful product will be such that appeals to a significant number of jurisdictions in considering renovations or reforms of their laws in the area of enterprise group in insolvency, but also such that is grounded on sound theoretical justifications.

In this respect, the recommendations (on which this chapter focused) seem as a major step in the right direction and may indeed be of significant appeal to policy makers in legal regimes. The recommendations are generally supportive of goals of insolvency laws while at the same time compatible with basic notions of company law. The Working Group took a cautious approach in its deliberations when considering measures based on ‘enterprise law’, especially where limited liability was at stake, and generally sought to preserve the merits of corporate separateness. At the same time, it provided measures that could enhance efficiency and equitable treatment of creditors in the context of insolvency proceedings against group members.

It was also suggested here that on certain aspects the Working Group seemed to have left too much room for legal systems to determine on the particular remedy that should be applied in the circumstances (when, for example, it refrained from devising recommendations on contribution orders). This may result with a degree of incoherency and uncertainty in the application of certain measures. However, this seems to be the realism of harmonization, not

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109 See WP.76/Add.1 (n 100), Para. 3.
110 These matters are further elaborated in Mevorach (n 9), ch 9.
111 See Section Two.
in the sense of agreeing on the lowest common denominator, but rather in the sense of working within a feasible scope in order to bring results. This approach incorporates the appreciation that change is brought gradually.