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Promotion of group restructuring and cross-entity liability arrangements

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ABSTRACT
Modern enterprises often operate as interconnected groups of companies. This is facilitated by various cross-entity liability arrangements, which aim at risk mitigation and control, and may contribute to the reduced agency cost of debt. However, they pierce limited liability (cross-guarantees) or impose correlation between the fates of separate entities (intercompany cross-defaults and ipso facto clauses). They can promote group exposure and disincentivise debtors from taking early actions to avoid insolvency. This paper explores the tools that are embraced to address these problems to achieve group restructuring. They include restrictions of cross-entity ipso facto clauses and extension of enforcement stays to group entities. I examine the ex ante and ex post effects of group liability arrangements, make a comparative overview of national law responses and suggest recommendations to find a balanced approach to cross-entity liability arrangements, enhance the existing legal regimes and form the basis for future reforms of insolvency laws.

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KEYWORDS Group restructuring; intragroup liability arrangements; cross-guarantees; ipso facto clauses; enforcement stay

1. Introduction

1.1. Background

Modern enterprises often exist in the form of networks of legal entities, linked to each other through control or significant ownership. Companies within such networks preserve their separate legal personality, as well as separate pools of assets and creditors. The rise of enterprise groups has been supported by the legal doctrines of limited liability and entity shielding. The former protects shareholders from liability for debts of the companies they create or invest in, while the latter ensures that creditors of shareholders

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cannot have a direct recourse against the assets of their companies.[1] In practice, however, both of these doctrines – and more generally entity separateness – may be weakened by various cross-entity liability arrangements, as is often the case in corporate groups.[2] These arrangements include intra-group support transactions (such as cross-guarantees, co-debtorship and intragroup provision of collateral) and contractual provisions binding several group members (e.g. cross-defaults and cross-entity ipso facto clauses). They favour a particular creditor (i.e. guaranteed creditor) if the debtor or other group entities default on their obligations or become financially distressed.

Cross-entity liability arrangements affect the behaviour of a debtor and the position of secured (guaranteed) and unsecured (non-guaranteed) creditors. On the one hand, cross-guarantees grant additional security to guaranteed creditors, as they acquire access to the asset pools of several companies in the event of default. They also minimise the negative effects of certain forms of group opportunism (e.g. asset shifting) and bring down information and monitoring costs.[3] Therefore, they could result in better lending terms and overall be ex ante efficient. On the other hand, group liability arrangements either pierce limited liability[4] or impose correlation between the fates of separate group entities, whose interests become intertwined. In financial distress, they can promote the spread of contagion across the group, have a detrimental impact on going concern value and misalign the interests of creditors of individual entities.[5] Besides, the threat of group-wide enforcement might disincentivize debtors from taking early actions to prevent insolvency. Thus, cross-liability arrangements may pose problems ex post.

[1]Hansmann and Kraakman refer to these doctrines as 'defensive asset partitioning' (protecting personal assets from company's shareholders) and 'affirmative asset partitioning' (shielding company's assets from creditors of its shareholders and managers). See Henry Hansmann, Reinier Kraakman, 'The Essential Role of Organizational Law' (2000) 110(3) Yale L.J. 387.

[2]Richard Squire, 'Shareholder Opportunism in a World of Risky Debt' (2010) 123 Harv. L. Rev. 1151, 1213, noting that intragroup guarantee arrangements are extremely prevalent. Jack F. Williams, 'The Fallacies of Contemporary Fraudulent Transfer Models as Applied to Intercorporate Guaranties: Fraudulent Transfer Law as a Fuzzy System' (1994) 15(5) Cardozo L. Rev. 1403, 1404, noting that guarantees by companies related to a corporate borrower constitute 'a common element of many financial transactions'. See also Richard Squire, 'Strategic Liability in the Corporate Group' (2011) 78 U Chi L Rev 605, 615, referring to the Posner's theory of explaining entity partitions by the desire to reduce monitoring costs and simplify risk assessment by creditors, but questioning its persuasiveness in light of the widespread use of cross-guarantees that transmit credit risk across subsidiary boundaries.

[3]Phillip Blumberg, 'Intragroup (Upstream, Cross-Stream, and Downstream) Guaranties under the Uniform Fraudulent Transfer Act' (1987) 9 Cardozo L. Rev. 685, 687, noting that intra-group guarantees protect creditors from 'possible intragroup manipulation.'

[4]William H. Widen, 'Corporate Form and Substantive Consolidation' (2007) 75 Geo. Wash. L. Rev. 237, 265, noting that 'intercompany guarantees create a type of substantive consolidation by contract.' Arguably, this 'contractual substantive consolidation' benefits only a creditor with a guarantee, making it closer to a veil piercing.

[5]Due to additional protection in insolvency, a guaranteed creditor can be compared to a creditor with *in rem* security rights. Such a creditor oftentimes chooses liquidation, while unsecured creditors usually prefer reorganisation, as they are likely to get little or nothing in liquidation. Henry T.C. Hu, Jay L. Westbrook, 'Abolition of the corporate duty to creditors' (2007) 107 Colum. L. Rev. 1321, 1353.

Insolvency law seeks to establish a balance between the interests of different stakeholders. Recent years have seen the rise of proceedings aimed at financial rehabilitation of debtors and at resolving their distress before insolvency. In 2019, in the EU, the Restructuring Directive was published (the 'Directive' or the 'Restructuring Directive').[6] Its goal is to ensure that economically viable enterprises have access to effective preventive restructuring frameworks to preserve operational continuity and to rearrange their capital structures.[7] It also promotes early restructuring attempts to address deteriorating economic conditions and rising debt levels.[8]

The Restructuring Directive recognises that greater coherence of restructuring and insolvency proceedings should facilitate restructuring of groups of companies with group entities located in different EU Member States.[9] It acknowledges that a 'restructuring framework should be available to debtors, including legal entities and, where so provided under national law, […] groups of companies.'[10] However, it does not explicitly tackle group restructurings or provide solutions to the problems which are peculiar to group insolvency cases, including those related to cross-entity liability arrangements. This may raise costs of restructuring in an enterprise group scenario, undermine its efficiency and require innovative solutions to be developed in national law.

1.2. Questions and scope

Inspired by the success of the US Chapter 11,[11] legislators around the world started reforms of insolvency law. For example, the UK has recently adopted the Corporate Insolvency and Governance Act 2020 (CIGA),[12] which introduces new procedures and measures to rescue companies in financial distress. The Netherlands has adopted the Act on Court Confirmation of Extrajudicial Restructuring Plans (WHOA) that aims at modernising Dutch insolvency law and introducing fast and flexible restructuring options.[13] Germany has followed by passing the Act on Further Development of Restructuring and Insolvency Law, incorporating the Enterprise Stabilization

[6]Directive (EU) 2019/1023 of the European Parliament and of the Council of 20 June 2019 on preventive restructuring frameworks, on discharge of debt and disqualifications, and on measures to increase the efficiency of procedures concerning restructuring, insolvency and discharge of debt, and amending Directive (EU) 2017/1132 (Directive on restructuring and insolvency).

[7]ibid Recitals 1, 2, 22.

[8]ibid Recital 22.

[9]ibid Recital 15.

[10]ibid Recital 24.

[11]11 U.S. Code Title 11.

[12]Corporate Insolvency and Governance Act 2020.

[13]*Wet homologatie onderhands akkoord*. For unofficial English translation of the WHOA and related documents, see <https://www.debrauw.com/insightsandopinions/draft-bill-continuity-companies-act-ii-wcoii/> accessed 26 April 2021. The WHOA is in force since 1 January 2021.

and Restructuring Act (StaRUG).[14] These new instruments include provisions targeting restructurings of groups of companies.

The question that arises in a group insolvency and restructuring context is how to establish a balance between contractual freedom of parties to frame their obligations and risks through cross-guarantees and ipso facto clauses, on the one hand, and efficient group restructuring, on the other. This paper concentrates on the legal mechanisms that aim at determining such a balance in practice. It explores whether the selected restructuring regimes offer solutions to the problems created by cross-entity liability arrangements and analyses the limits of these solutions from both ex ante and ex post perspectives. Among the selected regimes are the USA's (Chapter 11), the Netherlands' (WHOA) and Singapore's (Insolvency, Restructuring and Dissolution Act or IRDA).[15] Whereas the former has influenced many restructuring reforms around the world,[16] the latter portray themselves as the emerging restructuring hubs in Europe and Asia. References to other jurisdictions will also be made to complete or complement the picture.

Two relevant mechanisms are examined: (i) prohibition or limitation of ipso facto clauses and their operation in a group setting, and (ii) enforcement stays and the possibility of their intra-group extension. While looking at the rationale of these solutions and at their scope, the paper does not cover private international law aspects. It also leaves out third-party releases.[17]

The paper is organised as follows. Section 2 examines the justification of cross-entity liability arrangements, mainly focusing on their economic rationale and analysing their ex ante and ex post effects on the agency cost of debt, access to finance, managerial behaviour and creditors' incentives. Section 3 describes the rise of the rescue culture and argues that this development plays a key role in the appearance of tools facilitating group restructurings. Section 4 studies cross-entity ipso facto clauses and explains how the survival of an economically viable firm may be undermined by their operation. Section 5 considers the workings of an enforcement stay in an enterprise group context and notes that in closely integrated groups, the extension of

[14] *Gesetz zur Fortentwicklung des Sanierungs- und Insolvenzrechts*, Bundesgesetzblatt Jahrgang 2020, Teil I, Nr. 66, ausgegeben zu Bonn am 29. Dezember 2020. The StaRUG is in force since 1 January 2021.

[15] Insolvency, Restructuring and Dissolution Act 2018 (No. 40 of 2018). The IRDA is in force since 30 July 2020.

[16] It was noted that Chapter 11 deserves a prominent place in 'the pantheon of extraordinary laws that have shaped the American economy and society and then echoed throughout the world.' Elizabeth Warren, Jay L. Westbrook, 'The Success of Chapter 11: A Challenge to the Critics' (2009) 107(4) Mich. L. Rev. 603, 604.

[17] A third-party release leads to a release – total or partial discharge or amendment – of claims against third parties (e.g. co-obligors, guarantors and collateral providers) in the insolvency or restructuring proceeding of the principal debtor. In some cases, a third-party release may also be used to release the obligations of the primary debtor in a scheme concerning a non-primary debtor (e.g. guarantor). See *In the matter of Nordic Aviation Capital Designated Activity Company* [2020 No. 162 COS.]. Third-party releases are available in the UK, Singapore, Australia, Ireland, the Netherlands (WHOA) and Germany (StaRUG).

a stay to debtor's affiliates may be desirable. Section 6 describes the legal principles at play and proposes the recommendations for dealing with intra-group liability arrangements in restructuring to promote efficient group solutions and to safeguard interests of the affected parties. Section 7 concludes.

2. Rationale and types of cross-entity liability arrangements

2.1. Types of cross-entity liability arrangements

The existence of cross-entity liability arrangements is premised on the existence of a corporate group, where legally separate entities act as a single enterprise or otherwise support each other. In integrated groups of companies, financing is often coordinated and organised at a group level. This paper distinguishes two types of group liability arrangements, namely cross-liability arrangements and distress-triggered liability arrangements.

(i) *Cross-liability arrangements*. These contractual frameworks include cross-guarantees, co-debtorship and collateral arrangements. They are used to obtain beneficial lending terms from credit institutions and are common in the context of raising funds in capital markets, where a group of companies attracts financing through bond issuance by a special purpose financing vehicle (SPV).[18] In both cases, another group entity typically acts as a co-debtor, a guarantor or a collateral provider for the benefit of the primary debtor. Should the latter default, a guaranteed creditor may choose to request performance from that other entity, from both entities simultaneously ('double-dipping'),[19] or to enforce the collateral.

(ii) *Distress-triggered liability arrangements*. Examples of these arrangements are multiple. Among them are loan default penalties, loan pre-payment fees, intercompany cross-default provisions and cross-entity ipso facto clauses.[20] The latter two are specific to a corporate group environment, since they involve at least one other group entity on the debtor's side.

[18]INSOL International, 'INSOL Special Report, Restructuring Cross-border Groups: Key Considerations Around Foreign Tax and Finance-driven SPVs' (June 2020). See also Katharina Pistor, *The Code of Capital: How the Law Creates Wealth and Inequality* (Princeton University Press 2019) 51, describing how the integrated nature of Lehman Brothers' financial arrangements (intercompany guarantees and centralized cash management) contributed to the failure of the group entities, 'notwithstanding the corporate legal shields that had separated them.'

[19]See e.g. §43 German Insolvency Code (*Insolvenzordnung*, InsO), Article 61 Bankruptcy Act (Italy).

[20]Richard Squire, 'Distress-triggered liabilities and agency costs of debt' in Barry E. Adler (ed), *Research Handbook on Corporate Bankruptcy Law* (Edward Elgar Publishing 2020) 125, describing distress-triggered liabilities as 'contingent obligations of a corporate debtor that tend to be triggered by the debtor's own financial distress.' A guarantee issued by one group entity on the debt of another group entity is, according to Squire, also an example of distress-triggered liability. For the purposes of this paper, cross-guarantees and other arrangements granting a creditor access to estates of separate entities and arising from the same obligation are put into a separate category of cross-entity liability arrangements.

Cross-default clauses provide that a default on one obligation can be considered a default on another obligation. In a group scenario, a default on the obligation of one entity may automatically trigger a default on the obligation of an affiliated entity.[21] Ipso facto clauses are contractual provisions which entitle a creditor to terminate or amend a contract or to refuse performance under it if the debtor files for insolvency or restructuring. Importantly, whilst cross-default clauses require a default or a breach of a contract, ipso facto clauses are not tied to any non-performance or misbehaviour. The operation of ipso facto clauses may also be extended to encompass several group entities, which are not debtors themselves (cross-entity ipso facto clauses). For instance, an ipso facto clause might stipulate that a creditor shall be entitled to suspend contractual performance or to terminate or amend a contract, if any group member files for insolvency or requests a moratorium.

2.2. Economic rationale and ex-ante effects of cross-entity liability arrangements

Cross-liability arrangements, such as intragroup guarantees, have an important 'protective function'.[22] They provide additional security to a guaranteed creditor, as it acquires access to, and recourse against, the asset pools of two or more companies or obtains the value of collateral. Such a creditor also gets some protection from intra-group asset shifting or asset stripping – a transfer or taking out of key assets from one group entity to another, which enriches groups' shareholders but could be detrimental to the general body of creditors.[23]

Asset stripping is a type of activity that creates what Jensen and Meckling have referred to as the 'agency cost of debt'.[24] The agency cost of debt comprises (i) monitoring costs, incurred by creditors to limit managerial misbehaviour (e.g. through covenants and their enforcement), (ii) bonding costs, incurred by the debtor to reassure creditors that it will not engage in value-destroying intra-group transfers, and (iii) costs of undeterred misconduct, arising in a situation where the expected losses are borne by third parties, which induces debtors to overinvest. Cross-liability arrangements reduce the uncertainty for debtholders and therefore decrease the agency

[21] Anthony J. Casey, 'The New Corporate Web: Tailored Entity Partitions and Creditors' Selective Enforcement' (2015) 124 Yale L.J. 2680, 2689.

[22] Richard Squire, 'Limits to Group Structures and Asset Partitioning in Insolvency: Suppressing Value and Selective Perforation by Means of Guarantees' in *NACIIL Report, The 800-Pound Gorilla. Limits to Group Structures and Asset Partitioning in Insolvency* (Eleven International Publishing 2019) 13.

[23] Avery W. Katz, 'An Economic Analysis of the Guarantee Contract' (1999) 66 U Chi L Rev 47, 73-74. Henry Hansmann and Richard Squire, 'External and Internal Asset Partitioning: Corporations and Their Subsidiaries' in Jeffrey N. Gordon and Wolf-Georg Ringe (eds), *The Oxford Handbook of Corporate Law and Governance* (OUP 2018) 264.

[24] Michael C. Jensen and William H. Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 JFE 305.

cost of debt. This is due to the fact that these arrangements curtail the negative effects of intra-group asset shifting. They lower information and monitoring costs, because the guaranteed creditor does no longer need to actively monitor the debtor and transactions it enters into with its affiliates (i.e. related-party transactions). This additional security and cost saving for a guaranteed creditor may offset anticipatory losses and result in reduced costs of debt, inter alia, in lower upfront interest rates. Thus, entity-piercing liability arrangements may facilitate access to finance, improve credit supply and be ex ante efficient for the debtor,[25] its shareholders and the select creditors – guaranteed creditors – typically, banks and bank syndicates.

The picture becomes less clear and conclusive if we consider the position of non-guaranteed creditors. Liability on guarantees could dilute the recoveries of such creditors.[26] Squire calls it an 'opportunistic function' of intragroup guarantees.[27] The problem is that cross-entity liability arrangements are inherently opaque. Usually, a creditor is unaware of the web of contractual arrangements that a debtor is involved in. Even if he is, control over future arrangements is problematic and the monitoring costs may be excessively high, especially for unsophisticated creditors. These creditors are left in the dark and with a difficult task of calculating the risk of loss from the debtor's insolvency. Unlike the majority of *in rem* security interests, cross-liability arrangements are not subject to public registration as a precondition to their validity against third parties. This problem has been noted in academic literature,[28] but there are no generally accepted legal solutions to it. The dilution of potential returns to non-guaranteed creditors can force them to incur significant monitoring costs, ask for security or charge higher interest rates, ultimately increasing the agency cost of debt. However, these adjustments may be unavailable if all or most of debtor's assets have already been collateralised or where creditors cannot effectively negotiate the debt terms. This concerns involuntary creditors and more generally non-adjusting and poorly adjusting creditors – thus, the most vulnerable creditors.[29]

[25]John Armour. Antonia Menezes, Mahesh Uttamchandani, Kristin van Zwieten, 'How do creditor rights matter for debt finance? A review of empirical evidence' in Frederique Dahan (ed), *Research Handbook on Secured Financing of Commercial transactions* (Edward Elgar Publishing 2015) 3-25, more generally confirming that from an ex ante perspective, better protection of creditors' rights is associated with lower cost of credit and improved recoveries.

[26]Squire, Strategic Liability in the Corporate Group (n 2) 608.

[27]Squire (n 22) 14. Squire also claims that the 'costs of enforcing intragroup guarantees at the expense of the guarantor's general creditors usually outweigh the economic benefits.' See Squire (n 20) 126.

[28]Squire, Strategic Liability in the Corporate Group (n 2) 605, pointing out that creation of subsidiaries and overuse of guarantees undermines transparency, complicates bankruptcy proceedings and introduces other distortions. Jay L. Westbrook, 'Transparency in Corporate Groups, Brooklyn Journal of Corporate' (2018) 13 Brook. J. Corp. Fin. & Com. L. 33, 34, arguing that the 'very structure of a modern corporate group can make it the engine of injustice and fraud' and proposing as a solution a regime 'in which transparency is required with regard to the structure of a corporate group and the activities of each of its members.'

[29]Non-adjusting creditors are those creditors which do not adjust the size and terms of their claims to anticipate the future developments and the security interests encumbering the borrower's assets.

Another ex-ante effect attributed to cross-liability arrangements relates to the incentives of creditors to screen and monitor the debtor. Sophisticated lenders, who would otherwise keep track of debtor's recordkeeping and major transactions, lose the impetus to do so, because intragroup guarantees or collateral make them indifferent to the value allocation within the group.[30] The lack of creditor oversight and managerial insulation may facilitate inefficiencies and value-destroying behaviour, intensifying the problem of moral hazard. This is particularly problematic for enterprise groups with concentrated corporate ownership that might correlate with a higher risk of opportunistic behaviour by shareholders vis-à-vis creditors.[31]

The rationale and operation of distress-triggered liability arrangements, such as intercompany cross-default provisions and cross-entity ipso facto clauses are quite distinct. Cross-default provisions do not grant a creditor the access to asset pools of separate companies. Rather they seek to discipline debtors and produce additional monitoring benefits, as creditors can better calculate risks arising from group operations. In anticipation of financial problems, a cross-default provision entitles a creditor to refuse future performance or accelerate its existing claims. As a result, cross-default clauses may reduce risks, promote collection and enhance creditor's control and governance.[32] In this respect, they seek to improve creditor oversight and may counteract creditor disengagement caused by cross-liability arrangements.

Cross-entity ipso facto clauses could have a similar effect. According to Wood, the objective of ipso facto clauses is 'to introduce predictability as to whether a party may terminate without having to rely on vague notions of contract breach or anticipatory repudiation.'[33] Terminating a contract in a situation of debtor's financial distress can reduce the risk of prospective (potential) non-performance. Di Gennaro and Goldstein note the policing function of ipso facto clauses and compare them to financial and restrictive covenants in loan agreements (e.g. restrictions on debt levels, minimum cash flows and net assets). Both seek to deter the debtor from engaging in

Among such creditors are tort creditors, tax and regulatory claims, as well as voluntary creditors with few incentives or possibilities to bargain for security (e.g. due to a small size of claims or high transaction costs of negotiations). See Lucian Bebchuk and Jesse M. Fried, 'The Uneasy Case for the Priority of Secured Claims in Bankruptcy' (1996) 105 Yale L.J. 857, 864; Luca Enriques and Martin Gelter, 'How the Old World Encountered the New One: Regulatory Competition and Cooperation in European Corporate and Bankruptcy Law' (2007) 81(3) Tul. L. Rev. 577, 583.

[30] Squire, Strategic Liability in the Corporate Group (n 2) 617, arguing that in the absence of intragroup guarantees 'major lenders would pressure group managers to keep better records for each constituent entity, or to pare away extraneous subsidiary boundaries.'

[31] Aurelio Gurrea-Martínez, 'Insolvency Law in Emerging Markets' (2020) 3/2020 Ibero-American Institute for Law and Finance <https://ssrn.com/abstract=3606395> accessed 26 April 2021.

[32] David Hahn, 'The Roles of Acceleration' (2010) 8 DePaul Bus. & Com. L.J. 229, 231.

[33] Philip Wood, *Principles of Insolvency Law* (2nd edn, Sweet & Maxwell 2007) 16-025. Wood argues at para. 16-026 that the 'freeze or stay on self-help termination is unquestionably one of the most draconian and controversial of all the stays, because of the massive impact on transactions.'

excessively risky or opportunistic behaviour by creating a threat of triggering contract termination or acceleration.[34] Similarly, Che and Schwartz argue that ipso facto clauses are socially desirable because they improve managers' incentives to avoid financial distress and allow a solvent firm to exit from bad (unproductive) projects and avoid expectation damages.[35] To the extent that distress-triggered liability arrangements promote risk mitigation and provide additional means of control to a guaranteed creditor, they can reduce the risk of a moral hazard.

In sum, the economic rationale of cross-entity liability arrangements relates to risk control and risk mitigation. However, their ex ante effects on access to finance and corporate governance are not straightforward. It can be argued that they have a positive function – cross-guarantees and similar arrangements can reduce the agency cost of debt, resulting in lower interest rates and generally contributing to the group's ability to raise capital. This cost reduction is however selective and concerns only guaranteed creditors, while the outcome for non-guaranteed unsecured creditors might be the opposite, since they may have to incur high monitoring costs and sustain potential dilution of recoveries. The security-granting arrangements could also influence the degree of creditor oversight, because a guaranteed creditor may be indifferent to intra-group transfers of assets as it has a recourse against several or all group entities.[36] This can worsen the problem of moral hazard. In contrast, distress-triggered liability arrangements, including cross-defaults and cross-entity ipso facto clauses, can improve the overall

[34]Michael J. Di Gennaro and Harley J. Goldstein, 'Can Ipso Facto Clauses Resolve the Discharge Debate? An Economic Approach to Novated Fraud Debt in Bankruptcy' (2003) 1(3) DePaul Bus. & Com. L.J. 417, 435, noting that an ipso facto clause 'serves as a sweeping *in terrorem* clause designed to deter certain misbehavior, imposing a cost on a debtor who resorts to bankruptcy - therefore making activities that increase the likelihood of bankruptcy more costly.' Jackson refutes this argument by pointing out that the actual cost may be borne by unsecured creditors and not the debtor. He concludes that 'bankruptcy law is justified in ignoring [ipso facto clauses] because they may be destructive of the collective weal in bankruptcy.' See also Thomas H. Jackson, *The Logic and Limits of Bankruptcy Law* (Beard Books 2001) 42-43.

[35]Yeon-Koo Che and Alan Schwartz, 'Section 365, Mandatory Bankruptcy Rules and Inefficient Continuance' (1999) 15(2) J.L. Econ. & Org. 441.

[36]The guarantee does not make the creditor risk disappear, but it shifts the risk of monitoring to a guarantor. See Katz (n 23) 59, arguing that guarantees 'help protect creditors against some of the risks of debtor misbehavior or insolvency by shifting those risks to guarantors.' However, the ability of insider guarantors to efficiently perform the monitoring function may be questioned due to the close bonds between the main debtor and the guarantor in a group context. This is especially true for upstream guarantees, provided by subsidiaries with insufficient information on the group performance (information asymmetry) or the ability to monitor or influence the corporate parent. See Aart Jonkers, *Insider guarantees in corporate finance: An economic analysis of Dutch, US and German law* (PhD thesis 2020) 267, noting that guarantees in corporate finance typically shift the risk 'to inferior risk-bearers and inferior monitors, whereas the guaranteed creditors are often expert risk-bearers and expert monitors.' A similar problem of the reduced incentives to monitor the debtor by a sophisticated lender has been emphasised with respect to the provision of collateral. See Michael Manove, A. Jorge Padilla and Marco Pagano, 'Collateral versus Project Screening: A Model of Lazy Banks' (2001) 32(4) RAND J. Econ. 726.

group governance through their disciplining capacity, constraining moral hazard and excessive risk-taking.

2.3. Insolvency and ex-post effects of cross-entity liability arrangements

This section of the paper examines the effects of cross-liability arrangements on debtors' and creditors' behaviour in a situation of financial distress or vicinity of insolvency (ex post effects). It appears that these arrangements have a number of common characteristics, which may contribute to debtor and creditor opportunism and compromise efficient group restructuring.[37] I explore these characteristics through the lens of relationships between group entities, and between non-guaranteed (unsecured) and guaranteed creditors.

First, cross-entity liability arrangements intensify interdependence and increase correlation between group entities. Enforcement of intra-group guarantees or collateral, setting into motion cross-defaults and cross-entity ipso facto clauses create contagion, enabling the spread of distress across legal boundaries of enterprise group members. The threat of a group-wide enforcement action might serve as a significant deterrent to initiating restructuring proceedings or even starting negotiations over an out-of-court workout.[38] As a result, the debtor's management may be reluctant to take early measures to address financial difficulties of the debtor before it becomes insolvent. The pressure from a guaranteed creditor can also compel the debtor's managers to make selective payments in its favour, otherwise threatening a group-wide enforcement action.[39] If made in the

[37]Creditor opportunism is understood in broad terms as the pursuit of economic self-interest by a creditor even if such behaviour provokes negative side-effects on third parties. For discussion of the negative effects of creditor opportunism on economically efficient restructuring, see David Ehmke, 'Publicly Offered Debt in the Shadow of Insolvency' (2015) 16 EBOR 63. On the problem of holdouts and tragedy of anticommons in insolvency and restructuring, see Rolef J. de Weijs, 'Harmonisation of European Insolvency Law and the Need to Tackle Two Common Problems: Common Pool and Anticommons' (2012) 21(2) Int. Insolv. Rev. 67.

[38]Bob Wessels and Stephan Madaus, *Instrument of the European Law Institute – Rescue of Business in Insolvency Law* (2017) 395, noting that 'any restructuring is doomed if the commencement of proceedings may prompt financial creditors to accelerate the repayment of credit or licensors and lessors to terminate contracts.'

[39]Aart Jonkers, 'Selective Perforation by Means of Guarantees: Dutch Law' in *NACIIL Report, The 800-Pound Gorilla. Limits to Group Structures and Asset Partitioning in Insolvency* (Eleven International Publishing 2019) 75, arguing that 'intergroup guarantees can be seen as promises to the lender to make preferential payments, especially on the eve of bankruptcy.' An insider-guarantor can also put pressure on the borrower to pay the guaranteed creditor, indirectly profiting from such payment by limiting its exposure under the guarantee. The benefit is, however, indirect, as the payment goes to a non-insider creditor. Jason Gordon and Robert J. Landry III, 'The Risk-Shifting Effect of Business Bankruptcy: A Statutory Solution to Provide Additional Protections for Personal Guarantors of Debts by Closely-Held Business Ventures' (2015) 32(1) Emory Bankr. Dev. J. 67, 76, whereby the benefit of the guarantor is termed a 'phantom benefit'.

vicinity of insolvency, these payments may amount to preferential treatment and breach the principle of equal treatment of creditors.

Second, cross-entity liability arrangements strengthen the position of a guaranteed creditor compared to other (unsecured) creditors, leading to a specific form of creditor governance and control.[40] In this context, an analogy can be drawn with the interests and incentives of creditors, whose claims are secured by rights *in rem*. It has been noted in the literature that an over-secured or fully hedged creditor would usually prefer a quick and certain solution, such as foreclosure or liquidation, to a less predictable and riskier restructuring option.[41] In a situation where, due to a cross-entity liability arrangement, the lender may be interested in the quick enforcement against the estates of several group entities without bearing the downside of reorganisation, its position becomes analogous to that of a creditor over-insured on its loan. Just like a lender protected by a mortgage can dominate in insolvency proceedings,[42] a guaranteed creditor might drive group-wide (pre-)insolvency dynamics. For such a creditor, termination of a contract, acceleration of a claim or group-wide enforcement can be a way to withdraw its investment with minimal or no losses.

In other words, under certain circumstances cross-entity liability arrangements introduce an element of moral hazard, where a guaranteed creditor may have an incentive to promote the debtor's insolvency filing.[43] For unsecured, non-guaranteed and especially for non-adjusting creditors, however, this selective enforcement may entail large costs, especially if it leads to a

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[40]Kenneth M. Ayotte and Edward R. Morrison, 'Creditor Control and Conflict in Chapter 11' (2009) 1(2) J. Legal Analysis 511. See also Jay Westbrook, 'The Control of Wealth in Bankruptcy' (2004) 82(4) Tex. L. Rev. 795.

[41]Frederick Tung, 'Leveraging in the Board Room: The Unsung Influence of Private Lenders in Corporate Governance' (2009) 57 UCLA L. Rev. 115, 168, arguing that the full protection against insolvency risks induces the lender to refuse to renegotiate and that such a creditor could be worse than indifferent to a workout, as in some cases it 'would gain most by affirmatively sabotaging any workout effort and causing the debtor to fail.' Tung discusses a situation where a creditor purchases a credit default swap, which fully insures it against the risk of the borrower's non-payment. Horst Eidenmüller, 'Comparative Corporate Insolvency Law' in Jeffrey N. Gordon and Wolf-Georg Ringe (eds), *The Oxford Handbook of Corporate Law and Governance* (OUP 2018) 1019, emphasizing that not all creditors are alike and that '[f]ully secured creditors may press for premature liquidation even in cases where the company is not economically distressed.'

[42]The ever-increasing control by secured creditors over the insolvency process has been particularly emphasised in the US literature. See Douglas J. Baird and Robert K. Rasmussen, 'The End of Bankruptcy' (2002) 55 SLR 751; David A. Skeel, 'Creditors' Ball: The New Corporate Governance in Chapter 11' (2003) 152(2) U. Pa. L. Rev. 917, 918, noting that '[w]hereas the debtor and its managers seemed to dominate bankruptcy only a few decades ago, Chapter 11 now has a distinctly creditor-oriented cast.' See Robert Rasmussen, 'The end of bankruptcy revisited' in Barry E. Adler (ed), *Research Handbook on Corporate Bankruptcy Law* (Edward Elgar Publishing 2020) 42, mentioning among the factors strengthening the position of secured creditors in insolvency: 1998 amendments to Article 9 UCC, making it easier to obtain a blanket security interest in all debtor's assets; debtor-in-possession financing and the use of far-reaching lending covenants, giving a senior lender control over debtor's access to cash in its accounts.

[43]Di Gennaro and Goldstein (n 34) 441, describing that a creditor, protected by an ipso-facto clause, may be incentivized to force insolvency whenever the current market conditions make it beneficial, even if this is not in the collective interest.

group failure. The increased heterogeneity and fragmentation of creditors' interests amplify creditor coordination and collective action problems, which are further magnified in a group distress scenario.

Summarising the ex-post effects of cross-liability arrangements, it should be pointed out that they have a number of alarming traits. They are capable of misaligning creditors' interests and encouraging holdouts, thus complicating the adoption of a group turnaround or restructuring strategy. They can also discourage debtors from taking steps to avoid insolvency and initiate restructuring proceedings. This deterrent effect is linked to the fact that taking preventive actions may cause a guaranteed creditor to file its claims against debtor's affiliates pursuant to an intragroup guarantee or a cross-default provision in a contract, or to terminate or amend its contracts with them based on a cross-entity ipso facto clause. This behaviour has the potential to undermine the effectiveness of debtor's restructuring efforts, especially in circumstances where the failure of a single entity leads to a domino-like collapse of other group entities. The described problem becomes more pronounced in light of the trend towards promotion of early restructuring tools discussed in the next section.

3. The rise of rescue culture and group restructuring

The rise of the rescue culture is characterised by the proliferation of national laws seeking to promote restructuring of viable enterprises that are in financial difficulties and to minimise the negative impact of their failures. Over the last decade, Singapore,[44] the UK, the Netherlands, Spain,[45] France[46] and Germany, amongst others, have established restructuring-friendly legislation.[47]

The expansion of restructuring laws is likely to continue. In Europe, this trend has been influenced by the Restructuring Directive, which needs to be transposed into national laws of all EU Member States by 17 July 2021, with a possible extension of up to one year. Even though the Directive does not aim at full harmonisation of substantive insolvency law, it centres around the idea of crisis prevention and early action to forestall the escalation of financial problems and to avert insolvency. It rests on the premise that an early crisis response not only prevents losses of jobs, know-how and skills but

[44]Wee Meng Seng, 'The Singapore Story of Injecting US Chapter 11 into the Commonwealth Scheme' (2018) 15 ECFR 553.

[45]Ignacio Tirado, 'Scheming against the Schemes: A New Framework to Deal with Business Financial Distress in Spain' (2018) 15 ECFR 516.

[46]Emilie Ghio, 'Transposing the preventive restructuring directive 2019 into French insolvency law: Rethinking the role of the judge and rebalancing creditors' rights' (2021) 30(1) Int. Insolv. Rev. 54.

[47]For discussion of recent insolvency law reforms in a number of European jurisdictions, see David Ehmke et al., 'The European Union preventive restructuring framework: A hole in one?' (2019) 28 Int. Insolv. Rev. 184.

also maximises the total value to creditors.[48] The importance of a timely reaction to financial struggles has been emphasised in the literature.[49]

The rise of the rescue culture has coincided with the appearance of legal instruments which address insolvency of enterprise groups. The European Insolvency Regulation (EIR Recast),[50] the Bank Recovery and Resolution Directive (BRRD)[51] and the UNCITRAL Model Law on Enterprise Group Insolvency (MLEGI)[52] all contain provisions targeting financially distressed groups of companies. Some countries have also adopted special rules for group procedural consolidation in insolvency. Among them are Germany,[53] Italy,[54] Spain[55] and France.[56] These instruments promote cooperation and communication in group insolvencies and, to one extent or another, seek centralisation and coordination of crisis management and resolution within enterprise groups, while preserving entity separateness.

The rest of this paper studies the intersection of these current developments. In order to promote early restructuring of viable businesses, the Restructuring Directive provides for (i) the prohibition of ipso facto clauses[57] and (ii) a stay of individual enforcement actions.[58] The former is based on the understanding that early termination can endanger the ability of a debtor to continue operating during restructuring negotiations and implementation of a restructuring plan.[59] The latter is imposed with the aim of supporting the negotiations between a debtor and its creditors

[48]Restructuring Directive, Recital 2.

[49]Lorenzo Stanghellini et al. (eds), *Best Practices in European Restructuring: Contractualised Distress Resolution in the Shadow of the Law* (Wolters Kluwer 2018) 5, noting that 'restructuring and insolvency professionals unanimously consider late reaction to a crisis to be the single most important reason for businesses becoming unsustainable and heading towards liquidation.' Wessels and Madaus (n 38) Recommendation 1.21, stressing the importance of supporting 'early warning mechanisms that detect a deteriorating business development and signal the respective urgency to act.'

[50]Regulation (EU) 2015/848 of the European Parliament and of the Council of 20 May 2015 on insolvency proceedings (recast).

[51]Directive 2014/59/EU of the European Parliament and of the Council of 15 May 2014 establishing a framework for the recovery and resolution of credit institutions and investment firms.

[52]UNCITRAL Model Law on Enterprise Group Insolvency (2019). The MLEGI compliments the UNCITRAL Model Law on Cross-Border Insolvency (1997) and targets group insolvencies to encourage and enable coordinated responses to financial distress. For that purpose, it offers a wide range of special tools, including designation of a 'planning proceeding', which is led by a 'group representative' in order to develop a 'group insolvency solution'. The latter is designed in a flexible way to reflect 'a proposal or set of proposals developed in a planning proceeding for the reorganization, sale or liquidation of some or all of the assets and operations of one or more enterprise group members.' MLEGI, Article 2(f). For discussion of the MLEGI, see Irit Mevorach, 'A Fresh View on the Hard/Soft Law Divide: Implications for International Insolvency of Enterprise Groups' (2019) 40(3) Mich. J. Int. Law 505.

[53]InsO, § 3a, 269d-269i.

[54]Codice della crisi d'impresa e dell'insolvenza in attuazione della legge 19 ottobre 2017, n. 155, Art. 284.

[55]Ley Concursal, Artículo 25.

[56]LOI n° 2015-990 du 6 août 2015 pour la croissance, l'activité et l'égalité des chances économiques, adding Article L. 721-8 to the Code of Commerce.

[57]Restructuring Directive, Article 7(5).

[58]ibid Article 6.

[59]ibid Recitals 40 and 41.

and preserving the value of the insolvency estate.[60] However, as noted above, the Directive does not explicitly deal with enterprise group insolvency, thereby leaving its regulation to individual states. This is why it is unclear how the indicated tools can and should be adjusted to resolve financial distress of groups of companies. I explore this question in the following sections.

4. Ipso facto clauses and group financial distress

4.1. Ipso facto clauses and limits of freedom of contract

Cross-entity ipso facto clauses may result in a group-wide enforcement action, threatening solvency and survival of an economically viable corporate group or its part(s). These clauses terminate or amend contracts automatically upon a certain event (ipso facto is Latin for 'by the fact itself'), such as the opening of an insolvency or restructuring proceeding. Where they are invoked solely on account of negotiating a restructuring plan or requesting a temporal stay of enforcement, or in connection with any event associated therewith, early termination may negatively impact the debtor's business and its chances of turnaround.[61] Enforceability of ipso facto clauses reduces the negotiation power of the debtor and may be conducive to holdout behaviour by a guaranteed creditor. The risk of cancellation of key contracts can also deter debtors from seeking formal restructuring efforts and earlier help.

Historically, ipso facto clauses were permitted as emanating from freedom of contract. Thus, under English law prior to the most recent reforms (i.e. CIGA), it was generally assumed that provisions for termination of a contract upon bankruptcy or liquidation of a party were valid.[62] In *Belmont Park Investments Pty Ltd*,[63] the UK Supreme Court confirmed this view, as long as such provisions did not breach the anti-deprivation rule. This rule protects creditors by preserving assets of a debtor on or after the onset of insolvency.[64] It is mainly directed at avoiding 'intentional or inevitable evasion of the principle that the debtor's property is part of the insolvent estate.'[65] The scope of

[60]ibid Recital 32.

[61]Fabrice Robert-Tissot, 'The Effects of a Reorganization on (Executory) Contracts: A Comparative Law and Policy Study [United States, France, Germany and Switzerland]', III Bronze Medal Winner Paper (2012) 24, <https://www.iiiglobal.org/node/1557> accessed 26 April 2021, finding that the enforcement of ipso facto clauses could be inefficient 'for it would only advantage the non-debtor, but cause significant losses for the other creditors.'

[62]A few narrow exceptions covered the supply of utilities such as gas, water and electricity (Section 233 Insolvency Act 1986) and the supply of 'essential' goods and services (Section 233A Insolvency Act 1986)

[63]*Belmont Park Investments Pty Ltd v. BNY Corporate Trustee Services Ltd Butters v. BBC Worldwide Ltd* [2011] UKSC 38.

[64]The anti-deprivation rule asserts that 'there cannot be a valid contract that a man's property shall remain his until his bankruptcy, and on the happening of that event shall go over to someone else, and be taken away from his creditors.' *Ex parte Jay, In re Harrison* (1880) 14 Ch D 19, at 26 (Cotton LJ).

[65]*Belmont Park* (n 63) 106.

this rule is, however, limited and narrow.[66] It cannot be applied to 'bona fide commercial transactions which do not have as their predominant purpose, or one of their main purposes, the deprivation of the property of one of the parties on bankruptcy.'[67] Ipso facto clauses typically do not have as their 'main' purpose the deprivation of a debtor of its property, particularly in the context of financial transactions.[68]

Before the enactment of the Bankruptcy Reform Act of 1978, ipso facto clauses were honoured under US bankruptcy law.[69] In a number of cases they were not treated with favour,[70] but an express covenant of forfeiture – constituting an ipso facto clause – has long been held to be enforceable against the trustee in a bankruptcy case. This was irrespective of the nature of proceedings – insolvency or financial rehabilitation. Just like in the UK, the change in the attitude to the validity of ipso facto clauses in the USA required legislative intervention. This happened with the adoption of the Bankruptcy Code in 1978, which stipulates that ipso facto clauses – provisions in executory contracts and unexpired leases that terminate or modify them upon the commencement of an insolvency case – are unenforceable.[71] This shift can be attributed to the overall move towards rescue of financially troubled companies.[72]

The rise of the rescue culture has been accompanied by the adoption of various rules imposing limits on contractual freedom. One such limitation relates to the total or partial prohibition or restriction of ipso facto clauses. Recently a number of jurisdictions have introduced such limitations.[73] This

[66]Felicity Toube and Joanne Rumley, 'A Brave New World? Should the UK Ban Ipso Facto Clauses in Non-Executory Contracts?' (2018) 31(3) Insolvency Intelligence 78. Louise Gullifer and Jeniffer Payne, *Corporate Finance Law: Principles and Policy* (3rd edn, Hart Publishing 2020) 111, noting that 'the principle is of limited application.'

[67]*Belmont Park* (n 63) 104.

[68]Bob Wessels and Stephan Madaus (eds), *Rescue of Business in Europe. A European Law Institute Instrument* (OUP 2020) 208. Goode critically evaluates the English approach and convincingly argues that a contractual right may in practice constitute a valuable asset, whose termination can diminish the assets available to creditors, 'so that in form and in substance the termination operates as forfeiture.' Roy Goode, *Principles of Corporate Insolvency Law* (4th edn, Sweet & Maxwell 2011) 222.

[69]For a detailed historical account, see Vern Countryman, 'Executory Contracts in Bankruptcy: Part II' (1974) 58 Minn. L. Rev. 479.

[70]In a number of cases, courts, guided by considerations of equity and public interest, barred the enforcement of ipso facto clauses in order to prevent the forfeiture. See e.g. *Queens Blvd. Wine and Liquor Corp. v. Blum*, 503 F.2d 202 (1974), holding that a court may deny enforcement of a bankruptcy forfeiture clause on equitable grounds, where contract termination would be 'grossly inequitable and contrary to the salutary purpose of Chapter XI.' See also *Weaver v. Hutson*, 459 F.2d 741 (4th Cir. 1972). These cases remain controversial.

[71]11 U.S.C. § 365(e).

[72]Susan Block-Lieb, 'Fishing in Muddy Waters: Clarifying the Common Pool Analogy as Applied to the Standard for Commencement of a Bankruptcy Case' (1993) 42 Am. U. L. Rev. 337, 424, highlighting that the goal of debtor's financial rehabilitation was distinct from that of increasing distributions to creditors. See also Report of the Committee on the Judiciary together with Separate Supplemental, and Separate Additional Views, H.R. Rep. No. 95-595 (1977) 348, explaining that the goal of § 365 (e)(1) is to restrict the application of clauses that frequently hamper rehabilitation efforts.

[73]The list of such jurisdictions is provided in the Annex 1. For a country-by-country overview of the treatment of executory contracts and ipso-facto clauses in insolvency, see Jason Chuah and Eugenio Vaccari (eds), *Executory Contracts in Insolvency Law: A Global Guide* (Edward Elgar Publishing 2019).

move has also received support from standard-setting organisations.[74] Determining to what extent freedom of contract should be curbed to promote other legitimate values or goals, such as effective restructuring and estate value maximisation, is a policy question. Influenced by various policy considerations and stakeholder interests, countries have enacted different rules related to the restriction of ipso facto clauses. This is reflected in the variety of types of contracts carved out from the prohibition and in the differences in the material scope (i.e. types of proceedings covered) of such restrictions across jurisdictions.[75]

The question remains, how should a prohibition or a limitation of ipso facto clauses work in the context of enterprise groups?

4.2. Prohibition of ipso facto clauses and enterprise groups

The recent reforms relating to ipso facto clauses are primarily driven by the desire to promote rehabilitation of viable but financially distressed enterprises. In the prevailing economic and legal environment, such enterprises often exist in the form of corporate groups,[76] which may act as a single economic unit with group entities 'operating as divisions of a larger business and exercising little independent discretion.'[77] This manifests itself in the way group entities conclude contracts with, and financially support, each other, which results in cross-entity liability arrangements, including cross-entity ipso facto clauses. According to them, as anticipated, a filing for insolvency or rehabilitation by one group entity could trigger a change in the rights of an affiliated legal entity. Consider three different scenarios.

[74]UNCITRAL Legislative Guide on Insolvency Law, Part one and two, 2004, Ch. II, para. 118. EBRD Core Principles of an Effective Insolvency System, September 2020, Principle 11. FSB Key Attributes of Effective Resolution Regimes for Financial Institutions, 2014, I-Annex 5: Temporary stay on early termination rights.

[75]For example, the limitation of ipso facto clauses in the UK covers only contracts for the supply of goods and services. See Insolvency Act 1986, Section 233B. Australian law introduces more than 60 exclusions from the rule against ipso facto clauses, many of which cover common commercial contracts. See Christopher Symes and Jason Harris, 'Be Careful What You Wish For! Evaluating the Ipso Facto Reforms' *Oxford Business Law Blog* (13 September 2019) <https://www.law.ox.ac.uk/business-law-blog/blog/2019/09/be-careful-what-you-wish-evaluating-ipso-facto-reforms> accessed 26 April 2021. The WHOA uses the all-encompassing language 'commitments and obligations to the debtor', indicating broad coverage of the prohibition. See WHOA, Article 373(3). As to the material scope, in the USA the rule on ipso facto clauses extends to all cases under Chapter 11. In Singapore ipso facto restrictions apply to specified proceedings, which do not include winding up or receivership. In the Netherlands the limitations are arguably applicable only in the context of the preparation and confirmation of extra-judicial restructuring plans.

[76]For example, in Europe groups of companies have become the prevailing form of large-sized enterprises. See Report of the Reflection Group on the Future of EU Company Law, 5 April 2011, p. 59. There are also more than one million SMEs in Europe which have subsidiaries or joint ventures abroad. See Commission Staff Working Paper, Impact Assessment Accompanying the Proposal for a Directive, 22 November 2016, SWD(2016) 357 final, p. 35.

[77]UNCITRAL Legislative Guide on Insolvency Law, Part three, 2010, Ch. I, para. 10.

In the first scenario, parties agree that if the debtor files for insolvency or restructuring, the creditor should be able to terminate or alter the contract (**Scenario 1**). In this scenario, even if there are companies belonging to the debtor's enterprise group (i.e. debtor's affiliates), they remain 'untouched' by the ipso facto clause, so that the contractual provision in question is not a 'cross-entity' ipso facto clause. In the second scenario, the contract prescribes that, should some or any of the debtor's affiliates be subject to insolvency or restructuring proceedings, the creditor becomes entitled to terminate its contract with the debtor (**Scenario 2**). In this scenario the debtor is not itself in insolvency proceedings and contract termination is triggered by the position or behaviour of the debtor's affiliate. This is an example of a cross-entity ipso facto clause. The third scenario is identical to the second one other than for the fact that the debtor is itself in financial distress or becomes financially distressed due to the contract termination triggered by an ipso facto clause (**Scenario 3**). Such a debtor may also find itself in an insolvency or a restructuring proceeding. This is clearly another example of a cross-entity ipso facto clause.

In both Scenario 2 and Scenario 3, termination of the contract is caused by an event, occurring within an enterprise group, but not directly attributed to the debtor's actions. Are these two scenarios covered by the prohibition of ipso facto clauses? As explained below, the answer depends on the applicable law and the way it frames the prohibition. Another, equally important question is the normative one: should ipso facto clauses be prohibited if they relate to events concerning debtor's group affiliates and not the debtor itself?

These are not purely theoretical questions. Scenario 3 was analysed by the US Bankruptcy Court in a number of disputes arising from the insolvency of Lehman Brothers.[78] One case concerned the priority over, and entitlement to, the collateral comprising various assets and secured obligations between the noteholders and a Lehman Brothers credit default swaps counterparty. The noteholders purchased notes through a special purpose vehicle set up by Lehman Brothers ('Issuer'). The Issuer used this money to buy government bonds and make other investments vested in a trust corporation ('collateral'). The Issuer and Lehman Brothers Special Financing Inc. ('LBSF'), a subsidiary of Lehman Brothers Holdings Inc ('LBHI'), entered into a credit default swap. Under this agreement the Issuer paid to LBSF the interest on the collateral and LBSF paid to the Issuer the amounts due by the Issuer to the noteholders. The collateral was charged by the Issuer in favour of the trustee to secure the Issuer's obligations to both LBSF and the noteholders. The central question concerned the priority between the noteholders and LBSF in recourse to the collateral. The contract between the Issuer and LBSF had provisions

[78] *Lehman Bros. Special Fin. Inc. v. BNY Corporate Tr. Serv. Ltd. (In re Lehman Bros. Holdings Inc.)*, 422 B.R. 407 (Bankr. S.D.N.Y.2010).

which, on the occurrence of the specified events of default (e.g. insolvency of LBSF or LBHI), flipped the priority in favour of the noteholders ('flip clause'). Thus, in the event of default, the noteholders could recover their original investment by exercising their charge.

Addressing the conflict between the noteholders and LBSF, the US court began by stating that ordinarily and pursuant to the terms of the transaction documents, the rights of the swap counterparty took priority over those of the noteholders. However, in the case at hand, the swap agreements contained the flip clause that led to the reversal of the order of priority to the detriment of the insolvent swap counterparty. The court concluded that the respective clause was unenforceable as violating the ipso facto prohibition of the US Bankruptcy Code, hence giving priority to LBSF.[79] In contrast, English courts held that the respective provisions were valid and enforceable under English law and that they did not violate the anti-deprivation principle.[80]

What matters here are the US court's findings relating to the cross-entity operation of ipso facto rules. The court adopted a broad interpretation of the prohibition, reasoning that the Bankruptcy Code prohibited 'modification of a debtor's right solely because of a provision in an agreement conditioned upon "the commencement of *a case* under this title"' (original emphasis). According to the court, 'the language used is not limited to the commencement of a case by or against the debtor. Given the legislative history, the absence of such precise limiting language is significant.'[81] Some of the earlier versions of the rule (i.e. §365(e)(1)) referred to 'the commencement of a case under this Act *by or against the debtor*' (original emphasis). But the final version is more inclusive. In discussing the scope of the potential extension, the court raised an important question: 'under what circumstances is the bankruptcy case of another debtor sufficiently related to rights of the parties to such an executory contract that it is reasonable to trigger the *ipso facto* protections of these sections?'[82]

[79]The validity of flip clauses under US law remains disputable, though. In a number of later cases, courts have come to the opposite conclusion, holding that such clauses do not amount to prohibited ipso facto clauses. See *Lehman Bros. Special Fin., Inc. v. Bank of America NA*, 553 B.R. 476 (Bankr. S.D.N.Y 2016), aff'd 2018 WL 1322225 (S.D.N.Y. March 14, 2018). *Lehman Brothers Special Financing Inc. v. Branch Banking and Trust Company*, No. 18-1079 (2d Cir. August 11, 2020).

[80]*Perpetual Trustee Company Limited & another v. BNY Corporate Trustee Services Ltd & another* [2009] EWCA Civ 1160, holding that the 'effect of the "flip" provisions was thus not to divest LBSF [the debtor] of monies, property, or debts, currently vested in it, and to revest them in the Noteholders, nor even to divest LBSF of the benefit of the security rights granted to it. It was merely to change the order of priorities in which the rights were to be exercised in relation to the proceeds of sale of the collateral in the event of a default.' Confirmed in *Belmont Park* (n 63). For the analysis and the explanation of the complex facts and the underlying transactions, see Sarah Worthington, 'Good Faith, Flawed Assets and the Emasculation of the UK Anti-Deprivation Rule' (2012) 75(1) Mod. L. Rev. 112; Hugh Collins, 'Flipping Wreck: *Lex Mercatoria* on the Shoals of *Ius Cogens*' in Stefan Grundmann, Florian Möslein, and Karl Riesenhuber (eds), Contract Governance: Dimensions in Law and Interdisciplinary Research (OUP 2015) 395.

[81]*Lehman Bros. Special Fin. Inc.* (n 78).

[82]ibid.

Without offering a definite answer, the court noted that the Lehman Brothers group members comprised an 'integrated enterprise', so that 'he financial condition of one affiliate affects the others.'[83] The court referred to the 'Lehman corporate family' and considered that the Chapter 11 filings by the corporate parent and its affiliates constituted a 'singular event for purposes of interpreting this ipso facto language.'[84] Essentially, an insolvency filing by a corporate parent (i.e. LBHI) on 15 September 2008 created the legal protection against ipso facto clauses as applied to Lehman's subsidiaries.

This group-wide application of insolvency law was novel and pragmatic. In my opinion, it correctly reflected the purpose of the prohibition of ipso facto clauses, namely the preservation of the debtor's going concern value. In the context of a closely integrated group, the policy goals of estate value maximisation and debtor rehabilitation can only be achieved where other group entities (capital providers, operating entities, etc.) are considered.

Enforcement of an ipso facto clause may cause serious disruption to the debtor's business and have a material adverse effect on its operations and results. Importantly, this distinguishes Scenario 3 from Scenario 2. In Scenario 2, insolvency of a group affiliate does not endanger the financial position of the debtor. Where the debtor is solvent and this solvency is not jeopardised by the operation of a cross-entity ipso facto clause, the reasoning behind the prohibition of ipso facto clauses does not apply. This may be especially true for decentralised enterprise groups, consisting of independent and self-sustaining legal entities.[85] In Scenario 2, a cross-entity ipso facto clause should be honoured, since there is no compelling public interest which can outweigh the principle of freedom of contract. The prohibition of ipso facto clauses is underpinned by the goals of insolvency law. So long as insolvency is not implicated, contract law should predominantly govern the relations between the parties.

The following sub-section focuses on Scenario 3 and explores the extent to which the selected law regimes enforce cross-entity ipso facto clauses. I have divided them into three categories, depending on their clarity and scope.

4.3. Cross-entity ipso facto clauses and national law

4.3.1. Application to direct counterparties

The first category encompasses the formulations which refer only to the debtor itself and to its actions or financial position.

[83] *JPMorgan Chase Bank, N.A. v. Charter Communications Operating, LLC (In re Charter Communications)*, 419 B.R. 221 (Bankr. S.D.N.Y.2009). In this case the lender argued that only clauses tied to bankruptcy of the debtor (and not its affiliates) were unenforceable. The court disagreed and concluded that the lender shall remain bound by the original terms of the loan agreement. Read further Douglas G. Baird and Anthony J. Casey, 'No Exit? Withdrawal Rights and the Law of Corporate Reorganizations' (2013) 113 Colum. L. Rev. 1.

[84] *Lehman Bros. Special Fin. Inc.* (n 78).

[85] For the analysis of different 'prototypes' of group structures, based on the degree of integration and control, see Irit Mevorach, *Insolvency within Multinational Enterprise Groups* (OUP 2009), Chapter V.

For example, UK law mandates that a 'provision of a contract […] ceases to have effect when the company becomes subject to the relevant insolvency procedure if and to the extent that, under the provision […] the contract or the supply would terminate, […] because the *company becomes subject to the relevant insolvency procedure*'[86] (emphasis added). Along similar lines, Canadian law provides that if 'a notice of intention or a proposal has been filed in respect of an insolvent person, no person may terminate or amend any agreement […] *with the insolvent person* […] by reason only that (a) the insolvent person is insolvent; or (b) a notice of intention or a proposal has been filed in respect of the insolvent person'[87] (emphasis added). Both laws specifically refer to the debtor (insolvent person), whose insolvency triggers an ipso facto clause. Hence, extending the scope of the prohibition to events outside the domain of the debtor's insolvency may be problematic and would definitely require some creativity.

4.3.2. Implicit application to group entities

The second category includes provisions which seek to ensure that the goal of the prohibition of ipso facto clauses is not undermined through attempts to bypass it. For example, Singaporean law stipulates that no person may 'terminate or amend, or claim an accelerated payment or forfeiture of the term under any agreement […] with the company […] by reason only that the proceedings are commenced or that the company is insolvent.'[88] But it also adds that any 'provision in an agreement that has the effect of providing for, or permitting, *anything that, in substance, is contrary to this section* is of no force or effect'[89] (emphasis added). Australian law contains a similar provision that states that a 'right cannot be enforced against a body for: […] a reason that, *in substance, is contrary to this subsection*'[90] (emphasis added). Thus, courts need to look at the substance of the relevant legal rule. This may permit broad and purposive interpretation[91] and considering the efficiency of the rule against the economic reality of a corporate group.

The second category should also cover provisions which associate the prohibition of ipso facto clauses with commencement of an insolvency or a restructuring proceeding, but do not specify that such proceedings shall be opened against the debtor-direct counterparty. In this category are the

[86]Insolvency Act 1986, sec. 233B(3).
[87]Bankruptcy and Insolvency Act, sec. 65.1.
[88]IRDA, sec. 440(1).
[89]ibid, sec. 440(3).
[90]Corporations Act 2001, sec. 415D(1)(f).
[91]Aharon Barak, *Purposive Interpretation of Law* (Princeton University Press 2005) 28, explaining purposive interpretation in the following way: 'The interpreter does not deal with form alone, because divorced from its substance, form has no vitality. The interpreter does not deal with substance alone, because divorced from form, the substance cannot be actualized. The interpreter works with the form of the text, guided by its substance.'

USA,[92] France,[93] the Netherlands[94] and Austria.[95] The Restructuring Directive also connects the inoperability of an ipso facto clause to a request to open or the opening of a preventive restructuring proceeding, as long as the effects of such an ipso facto clause are detrimental to the debtor.[96]

4.3.3. *Explicit application to group entities*

The third category comprises of the provisions that explicitly address cross-entity ipso facto clauses. Among the reviewed laws, I have found only one piece of legislation that falls within this category, namely the BRRD. The BRRD directly envisages the enterprise group context and invalidates cross-entity ipso facto clauses triggered by the implementation of early intervention measures and the use of resolution powers.[97] It stipulates that:

> Provided that the substantive obligations under the contract […] continue to be performed, a crisis prevention measure […] shall not, per se, make it possible for anyone to […] exercise any termination, suspension, modification, netting or set-off rights, including in relation to a contract entered into by: (i) a subsidiary, the obligations under which are guaranteed or otherwise supported by a group entity; (ii) any group entity which includes cross-default provisions.[98]

Thus, the adoption of resolution measures with respect to a parent company (e.g. pursuant to a single point of entry strategy) should not affect contractual rights of its subsidiaries, provided that they do not default on their substantive obligations. The BRRD describes two cases where a cross-entity ipso facto clause becomes unenforceable.

In the first case, an obligation under the contract containing an ipso facto clause is guaranteed or supported by another group entity. This requirement indicates that the contract needs to implicate at least two group entities. Cross-guarantees and other forms of intra-group financial support characterise closely integrated banking groups. While capable of improving efficiency in the attraction, allocation and management of liquidity within the banking group, in times of crisis these arrangements may facilitate intra-group exposure and represent avenues of contagion.[99] The rule limiting the effect of an ipso-facto clause

[92] 11 U.S. Code Title 11, § 365(e), referring to 'the commencement of a case under this title.'

[93] Commercial Code, Article L. 622-13, referring to 'the commencement of safeguard proceedings.'

[94] WHOA, Article 373(3), referring to 'acts that are directly related and reasonably necessary to the implementation of the plan.'

[95] Insolvency Act (Austria), § 25b(2), referring to 'the event of the opening of insolvency proceedings.'

[96] Restructuring Directive, Article 7(5). Notably, the original Proposal used a more restrictive language and covered clauses operating 'solely by reason of the debtor's entry into restructuring negotiations.'

[97] For the discussion of resolution tools and their effects on contracts entered into by the failing institution, see Francisco J. Garcimartín Alférez and Sara Sánchez Fernández, 'Resolution and contracts' in Matthias Haentjens and Bob Wessels (eds), *Research Handbook on Cross-Border Bank Resolution* (Edward Elgar Publishing 2019) 201.

[98] BRRD, Article 68(3).

[99] Basel Committee on Banking Supervision (BCBS), *Report on intra-group support measures* (2012) 4, noting that intra-group exposures/transactions and support measures have the potential to adversely affect the solvency, liquidity and profitability of individual entities within a group. See also BCBS,

seeks to minimise or restrict such group exposure. Additionally, the BRRD mentions that an obligation may be 'otherwise supported' by a group entity. It does not offer any further clarification with respect to the type of support meant or the corporate relation between the two entities. But taking into account the broad definitions of 'group entity'[100] and 'group',[101] it appears that 'support' should cover downstream (parent-subsidiary), upstream (subsidiary-parent) and cross-stream (subsidiary-subsidiary) support. As to its nature, the term 'support' is wide enough to encompass different forms of intra-group transactions, including co-debtorship, transfers of capital and collateral, and interbank lending to the extent that they relate to the contract in question.

The second case relates to contracts that contain cross-default provisions. The reason for the restriction of ipso facto clauses in these contracts is similar to that concerning intra-group support. It aims at stifling the spread of contagion in a banking group, which can potentially deter and complicate the application of early intervention measures and resolution tools. The fundamental feature of cross-default provisions is their ability to affect separate contracts and separate companies, increasing interdependence and the risk of cross-border contagion. For example, a cross-default may 'give the affiliate's counterparties the right to terminate their contracts if the holding company defaults or files for bankruptcy.'[102] The inherent power of cross-defaults to transmit risk across entity lines has resulted in several initiatives to restrict their use and application in practice.[103] The limitation imposed by the BRRD should be placed alongside such initiatives.

5. Operation of enforcement stay in group context

5.1. Extension of enforcement stay to third parties

One of the key features of recent restructuring laws is that they provide for a possibility to stay individual enforcement actions, which gives a debtor a

International Organization of Securities Commissions (IOSCO) and International Association of Insurance Supervisors (IAIS), *Intra-Group Transactions and Exposures Principles* (1999), listing various types of intra-group transactions and exposures.

[100] BRRD, Article 2(1)(31).

[101] BRRD, Article 2(1)(26).

[102] David A. Skeel, 'The new synthesis of bank regulation and bankruptcy in the Dodd-Frank era' in Barry E. Adler (ed), *Research Handbook on Corporate Bankruptcy Law* (Edward Elgar Publishing 2020) 86.

[103] One such initiative is headed by the International Swaps and Derivatives Association (ISDA). ISDA developed a number of Stay Protocols. For example, ISDA 2014 Resolution Stay Protocol provides that adhering parties agree not to exercise certain cross-default and early termination rights if an affiliate of a counterparty becomes subject to certain insolvency regimes, such as the US Bankruptcy Code or receivership under the FDI Act. ISDA 2014 Protocol was subsequently replaced by ISDA 2015 Universal Protocol, but the approach to cross-defaults has not substantially changed. The main idea behind addressing default rights pursuant to ISDA Protocols is that 'a failure of one part of a SIFI should not necessarily lead to defaults and close-outs of derivatives and repos sitting in affiliates of the SIFI, if the affiliate is still performing on its obligations.' Stephanie Massman, 'ISDA Resolution Stay Protocol: A Brief Overview' *Harvard Law School Bankruptcy Roundtable* (10 February 2015) <https://blogs.harvard.edu/bankruptcyroundtable/2015/02/10/isda-protocol-a-brief-overview/> accessed 26 April 2021.

breathing space, safeguards its going concern value and improves its position in negotiations with creditors.[104] However, success of a restructuring will often depend on the preservation of financial and operational links with other group entities. The threat of enforcement against affiliates of the debtor (co-debtors, guarantors) can substantially weaken its bargaining power. In this respect, the effect of a group-wide enforcement may be analogous to cross-entity ipso facto clauses. The main difference is that, in contrast to ipso facto clauses, which are not associated with a default or misbehaviour, enforcement of claims against third parties could arise from a default.

One way to secure a stay for group entities is to initiate separate insolvency or restructuring proceedings against them. However, this may drive up the transaction costs and substantially complicate coordinated group restructuring. The question is whether in order to preserve the overall value of a group enterprise, a stay can be extended to debtor's affiliates and, if the answer is positive, under which conditions it should happen. Similar to ipso facto clauses, the answer very much depends on applicable law.

UNCITRAL considers the extension of a stay to debtor's affiliates to be beneficial, especially where there is 'interrelatedness of the business of the group'.[105] This is the case where finance is arranged on a group basis (e.g. SPVs, cross-guarantees). The Restructuring Directive does not clearly authorise such an extension.[106] Yet it acknowledges that, if so provided under national law, it should be possible for a stay to apply for the benefit of third parties, including guarantors and collateral givers.[107] Ultimately, the Directive does not offer much guidance on the nature of third parties (e.g. group entities or not) and conditions under which a stay needs to benefit them.

5.2. Scope of enforcement stays in national law: towards group extension

This section looks into national laws of three jurisdictions – the USA, Singapore and the Netherlands – to determine the scope of a restructuring-related enforcement stay available in each of them. Crucially, it examines whether such an enforcement stay may be given an extension effect for the benefit of debtor's group members that are not themselves subject to

[104]Restructuring Directive, Article 6. Irit Mevorach and Adrian Walters, 'The Characterization of Pre-insolvency Proceedings in Private International Law' (2020) 21 EBOR 855, 863, noting that Chapter 11 'was designed to promote restructuring by encouraging firm managers to negotiate and confirm a plan of reorganization […] within the shelter provided by a statutory moratorium – the automatic stay.'
[105]UNCITRAL Legislative Guide on Insolvency Law, Part three, 2010, Ch. II, para. 40.
[106]Restructuring Directive, Articles 6 and 7.
[107]ibid Recital 32.

insolvency or restructuring proceedings. If such an extension is possible, I will discuss its conditions and scope.

5.2.1. US law: limited possibility of stay extension

The restructuring reforms in many parts of the world are inspired by Chapter 11, which is therefore a good starting point. Under the US Bankruptcy Code, filing a voluntary petition automatically opens the case and imposes a worldwide stay on debt enforcement actions by all creditors, whether secured or unsecured.[108] As a general rule, the enforcement stay does not extend to third parties.[109] This rule is based on the language of the Bankruptcy Code, which states that the bankruptcy petition 'operates as a stay, applicable to all entities, of […] any act to collect, assess, or recover a claim *against the debtor* that arose before the commencement of the case under this title'[110] (emphasis added).

Nevertheless, the power of a court to enjoin actions against third parties has been recognised in exceptional circumstances,[111] where such actions interfere improperly with the purposes of bankruptcy law or where 'there is such an identity between the debtor and the third-party defendant that […] a judgment against the third-party defendant will in effect be a judgment or finding against the debtor.'[112] The extension of a stay has also been allowed where a claim against a third party was considered to have 'an immediate adverse economic consequence for the debtor's estate'[113] and where the 'stay protection is essential to the debtor's efforts of reorganization.'[114] For example, in 2016, in *Caesars* the court issued an injunction to prevent indenture trustees and holders of notes issued by the debtor from pursuing suits against the debtor's corporate parent, acting as a guarantor.[115] It accepted that the debtor's reorganisation depended heavily on the parent's financial contribution, which would have been undermined by guarantee litigation. According to the court, extension of a stay furthered public interest in a successful reorganisation, since 'reorganizations preserve value for creditors and ultimately the public.'[116]

[108] 11 U.S. Code § 362.

[109] *Credit Alliance Corp. v. Williams*, 851 F.2d 119 (4th Circ. 1988); *In re S.I Acquisition, Inc.*, 817 F.2d 1142, 1147 (5th Cir.1987); *In re Supermercado Gamboa*, 68 B.R. 230, 232 (Bankr.D.P.R.1986); *Reliant Energy Servs., Inc. v. Enron Canada Corp.*, 349 F.3d 816, 825 (5th Cir.2003).

[110] 11 U.S. Code § 362(a)(6).

[111] The legal basis for extending a stay to non-debtor parties is not obvious. Some courts base their decisions on § 105(a) of the US Bankruptcy Code (*In re Calpine Corp.*, 365 B.R. 401 (S.D.N.Y. 2007). Other courts rely on § 362(a), even though it does not explicitly provide for such an extension (*Queenie Ltd. v. Nygard International*, 321 F.3d 282, 287 (2d Cir. 2003).

[112] *Reliant Energy Services, Inc. v. Enron Can. Corp.*, 349 F.3d 816, 825 (5th Cir. 2003).

[113] *Ritchie Capital Management, L.L.C. v. Jeffries*, 653 F.3d 755 (8th Cir. 2011).

[114] *In re Union Trust Philadelphia, LLC*, 460 B.R. 644 (E.D. Pa. 2011); *In re Hart*, 530 B.R. 293 (Bankr. E.D. Pa. 2015); *In re Saxby's Coffee Worldwide*, LLC, 440 B.R. 369 (Bankr. E.D. Pa. 2009).

[115] *In re Caesars Entertainment Operating Co.*, Inc., 561 B.R. 441, 76 Collier Bankr. Cas. 2d (MB) 746 (Bankr. N.D. Ill. 2016).

[116] ibid.

However, it has been noted that case law on the extension of enforcement stays in the US is rather 'confusing' as to the appropriate standard.[117] But it is clear that the possibility to enjoin litigation against third parties is limited and is reserved for 'unusual circumstances'. This may be one of the reasons why the practice of simultaneous bankruptcy filings by several group entities, each securing a separate stay and their coordinated handling by a single court are so prevalent in the USA.[118]

5.2.2. Singapore and the Netherlands: extension of stay to group entities

The United States is not the only jurisdiction that adheres to the *debtor-centric* approach.[119] Yet a few countries have set a *group-centric* approach focused on group restructurings.[120] This article discusses two such regimes, namely the Singaporean IRDA and the Dutch WHOA. Both Singapore and the Netherlands present themselves as the emerging restructuring hubs, including for restructuring of multinational enterprise groups. Both have introduced the cutting-edge tools inspired by Chapter 11 and English schemes of arrangement. Both are unique in allowing an extension of an enforcement stay to group entities.

5.2.2.1. Singapore. In 2017 Singapore reformed its law to enhance its attractiveness as the lead jurisdiction for global cross-border restructurings.[121] Among many other elements, the reforms introduced a moratorium that restrains commencement or continuation of legal actions against the debtor. They also added the possibility of extending the moratorium to group entities that are not subject to proceedings in Singapore.[122] This possibility was first introduced in the Companies Act[123] and is now located in the

[117]Shlomo Maza, 'Enjoying Third Party Litigation under §362' (2017) 26 Norton J. Bankr. L. & Prac. (online version).

[118]This practice is facilitated by the 'affiliate-filing rule' of 28 U.S. Code § 1408 and Rule 1015(b) of the Federal Rules of Bankruptcy Procedure. The affiliate-filing rule promotes reorganisation of an entire business enterprise as may be necessary. Another reason for group filings may be the general unavailability of such remedy as a third-party release in the USA. See Dorothy Coco, 'Third-Party Bankruptcy Releases: An Analysis of Consent Through the Lenses of Due Process and Contract Law' (2019) 88 Fordham L. Rev. 231.

[119]For example, in *State Bank of India vs. V. Ramakrishnan and Ors.* (14.08.2018 - SC), interpreting section 14 of the Insolvency and Bankruptcy Code 2016, the Supreme Court of India clarified that the insolvency moratorium did not extend to a guarantor. See also §89 InsO, seeking protection of debtor's insolvency estate.

[120]See also the StaRUG, §49(3), which permits the extension of a stay of actions arising from intra-group liability arrangements to protect guarantors and collateral providers.

[121]For an evaluation of Singapore reforms, see Gerald McCormack and Wai Yee Wan, 'Transplanting Chapter 11 of the US Bankruptcy Code into Singapore's restructuring and insolvency laws: opportunities and challenges' (2019) 19 JCLS 69.

[122]Prior to the 2017 reforms, the case law on the issue was not settled. For example, in *Pacific Andes Resources Development Ltd* [2016] SGHC 210, the court opined that 'a scheme of arrangement is territorial in nature and therefore the protective relief that s 210(10) offers to facilitate a scheme ought to also be territorial.'

IRDA. According to it, the court may, on the application of a company that is a subsidiary, a holding company or an ultimate holding company (related company) of the subject company (debtor), restrain commencement or continuation of any proceedings or enforcement actions, including enforcement of security rights, against a related company.[124] The IRDA imposes a number of conditions for the extension of a moratorium to debtor's affiliates.[125]

First, a stay should be granted to the debtor itself.[126] Hence, the restraint of proceedings and actions against debtor's affiliates may be viewed as an extension of the original stay.[127] Second, the related company shall not be subject to an order or resolution for the winding up. This requirement emphasises the goal of financial rehabilitation and not liquidation. Third, the related company must play a 'necessary and integral role' in debtor's restructuring.[128] This constitutes one of the key requirements. Fourth, taking actions against the related company should pose a risk of frustrating the proposed compromise or arrangement. Fifth, the court has to be satisfied that creditors of the related company are not 'unfairly prejudiced' by a stay of proceedings or actions.

To conclude, Singapore has a flexible and group-mindful regulation, permitting the application of restraining measures to debtor's affiliates to ensure efficient restructuring. It is notable that the IRDA does not limit the extension of a stay to group entities that act in a specific capacity, such as guarantors or collateral givers. It is therefore capable of covering various scenarios, taking into account the position of creditors, as well as organisational and financial links within the group. It also does not impose a requirement that a related entity, benefiting from a stay, should itself be in financial distress, although in integrated groups, and given the requirement that creditors shall not be unfairly prejudiced, this will often be the case.

5.2.2.2. The Netherlands. In 2020, insolvency and restructuring law has been significantly reformed in the Netherlands. The discussions about the

[123]Singapore Companies Act, sec. 211C (repealed by the IRDA).
[124]IRDA, sec. 65(1).
[125]IRDA, sec. 65(2).
[126]On the nature and extraterritorial application of a stay, see Manoj Pillay Sandrasegara, Sim Kwan Kiat, 'Report on Singapore' in *Corporate Restructuring and Insolvency in Asia 2020, ABLI Legal Convergence Series* (2020) 614.
[127]In interpreting sec. 211B(1) of the Companies Act (now replaced by sec. 64 of the IRDA), which provides for an automatic stay, the court in *Re IM Skaugen SE* held that when applying for a stay, the debtor needs to provide evidence of support from company's creditors of the restructuring. It stressed that in a group restructuring context, the 'court cannot ignore and indeed must pay heed to the overall support of the creditors for the group restructuring efforts.' *Re IM Skaugen SE* [2018] SGHC 259 at para. 63.
[128]For background, see Committee to Strengthen Singapore as an International Centre for Debt Restructuring, *Report of the Committee* (20 April 2016) <https://www.mlaw.gov.sg/news/public-consultations/public-consultation-on-the-report-of-the-committee-to-strengthen> (accessed 26 April 2021).

improvement of the national insolvency law framework to promote the adoption of extrajudicial restructuring plans accelerated since 2012, leading to the WHOA, which came into effect on 1 January 2021. Before then, restructuring options had been limited and the existing insolvency procedures had proven ineffective for the purposes of rescuing financially distressed companies.[129]

The WHOA introduces a stay (*afkoelingsperiode*), under which 'any power of third parties to recover debtor's assets or to claim assets under the debtor's control may be exercised only with authorization of the court.'[130] A stay may be ordered if it is necessary for the continuation of debtor's business during negotiations of a restructuring plan and where it may reasonably be assumed to serve the interests of debtor's joint creditors and not cause substantial harm.[131] The question remains whether a stay can reach debtor's affiliates.

Before answering this question, it is worth noting that the WHOA takes into account the group context.[132] In particular, it permits a restructuring plan to provide for an amendment of creditors' rights against the legal entities that form one group with the debtor (i.e. third-party release).[133] The rights of creditors towards debtor's affiliates must intend to satisfy or to secure performance of debtor's obligations (i.e. cross-guarantees and collateral arrangements) or of obligations for which those legal persons are liable with the debtor (i.e. co-debtorship). Among other requirements, the WHOA states that a group entity subject to a release should be 'in a situation in which it may reasonably be assumed that it will be unable to continue paying its debts.'[134] In other words, there must be a threat of insolvency that justifies court's intervention, so that the restructuring process is not disrupted or undermined by creditors' actions.[135] The two remaining requirements are consent of the to-be-released group entity and court's jurisdiction over it.[136] Besides, the best interest of creditors test should be

[129]Explanatory Memorandum to the Draft Act on Court Confirmation of Extrajudicial Restructuring Plans.
[130]WHOA, Article 376(2).
[131]WHOA, Article 376(4).
[132]The definition of a 'group' is given in the Dutch Civil Code (Article 2:24b). A group 'is an economic unit in which legal persons […] are organizationally interconnected. Group companies are legal persons and commercial partnerships interconnected to each other in one group.' The existence of economic unity and organisational interconnectedness are therefore the main characteristics of a corporate group under Dutch law. They highlight interdependence of group entities, importance of group synergies and (typically) centralized management.
[133]WHOA, Article 372(1). See Michael Veder and Adrián Thery, 'The release of third party guarantees in pre-insolvency restructuring plans' in Dennis Faber et al. (eds), *Trust and Good Faith across Borders, Liber Amicorum Prof. Dr. S.C.J.J. Kortmann* (Wolters Kluwer 2017).
[134]WHOA, Article 370(1).
[135]Reinout Vriesendorp and Wies van Kesteren, 'De WHOA en de rechter: een leidraad' (2019) 36 Tijdschrift voor Insolventierecht 277.
[136]The jurisdiction over legal entities for the purposes of the WHOA may be established either on the basis of the centre of main interests (COMI) as defined in the EIR Recast, or by virtue of a sufficient nexus with the Netherlands.

satisfied, meaning that creditors should not be worse off than in the event of liquidation of debtor's assets in insolvency.[137]

If a restructuring plan entails an amendment of creditor's rights against another group entity, the debtor can take the lead in the procedure and request a court to order a stay for the benefit of that group entity.[138] The extension of a stay is premised on the proposed amendment of creditors' rights against the group entity in the restructuring plan. This is why in order to be eligible for a stay, the relevant group entity must satisfy the conditions laid down for a third-party release. Unlike the IRDA, the WHOA does not impose a condition that extension of a stay should be necessary for the success of the debtor's restructuring. However, considering the aim of the original stay, the rationale behind a third-party release (i.e. the efficiency of a group restructuring) and the requirement of compliance with the best interest of creditors test applied at an individual entity level, this condition may be derived on the basis of a systematic (or contextual) and purposive (or teleological) interpretation.

The review of the three national approaches shows a great variety of attitudes to, and criteria for, the extension of a stay to the benefit of debtor's affiliates. Their summary and comparison are provided in the Annex 2. US law appears to be the most restrictive, since it empowers a court to enjoin actions against third parties in rare and exceptional circumstances. The exact configuration of these circumstances is ambiguous, fact-sensitive and may vary from one court district to another. In contrast, the law in both Singapore and Dutch clearly allows for a stay covering debtor's related companies. Nonetheless, there are important differences between them. The WHOA places a stay in the context of a restructuring plan that seeks to amend creditors' rights against related companies and targets debtor's guarantors, security providers and co-debtors. Singapore takes a more flexible position. It does not make a stay conditional upon a particular type of contractual relations, amendment of creditors' rights or financial position of the related entity. Instead, it requires that a stay be integral to debtor's restructuring.

6. Cross-entity liabilities and group restructuring: the way forward

6.1. Principles at play

Rules prohibiting or limiting ipso facto clauses and imposing enforcement stays to encourage restructuring of financially distressed but economically viable businesses have initially been developed to address individual debtor insolvencies. However, a gradual recognition of the specificity of

[137]WHOA, Article 384(3).
[138]WHOA, Article 372(3).

group structures and the desire to tailor insolvency law to accommodate them in the most efficient way, have resulted in the extension or adjustment of these rules to the environment of an enterprise group. This has not led to full harmonisation of national laws. The previous sections have pointed out the diversity of approaches adopted in national law to deal with cross-entity liability arrangements and to promote group-mindful restructurings. This section seeks to elicit the common principles or fundamental values on which future reforms and harmonisation attempts could be based. It also proposes the recommendations to ensure a balanced solution to cross-entity liability arrangements in the group restructuring context.

6.1.1. Protection of legitimate expectations and freedom of contract

In his analysis of the major principles of international insolvency law, Bork noted that protection of creditors' expectations 'is an important pillar of every legal order and a basic tenet to be enforced under the rule of law.'[139] Once parties have agreed on certain rights and obligations, they should be able to rely on their stability and continuity. This pillar is closely related to another fundamental principle, namely freedom of contract, pursuant to which parties should be free to select one another as contractual partners and to choose their own terms.[140] This applies to the freedom of parties to make arrangements that aim to minimise or control the risks in case of a default, inter alia, by entering into cross-entity liability arrangements.

Invalidation or partial or total unenforceability of cross-entity ipso-facto clauses and imposition of a wide enforcement stay due to insolvency or reorganisation of a group entity encroach on contractual freedom and may undermine legitimate expectations of counterparties.[141] A contract should not be disregarded without compelling reasons and a fair balance between the interests and rights of various stakeholders. In addition, any limitation on pre-insolvency contracting and pre-insolvency entitlements should be

[139]Reinhard Bork, *Principles of Cross-Border Insolvency Law* (Intersentia 2018) 143.

[140]Ewan McKendrick, *Contract Law: Text, Cases, and Materials* (6th edn, OUP 2014) 13. Freedom of contract is, of course, not absolute and there are many exceptions imposed to protect weaker parties, ensure competition and fairness. See Michael J. Trebilcock, *The Limits of Freedom of Contract* (Harvard University Press 1997). Roger Brownsword, *Contract Law. Themes for the Twenty-first Century* (2nd edn, OUP 2006) Chapter 3. Paul S. Davies, Magda Raczynska (eds), *Contents of Commercial Contracts: Terms Affecting Freedoms* (Hart Publishing 2020). See also Richard A. Epstein, 'Contracts Small and Contracts Large: Contract Law through the Lens of Laissez-Faire' in F.H. Buckley, *The Fall and Rise of Freedom of Contract* (Duke University Press 1999) 28, distinguishing three interrelated concepts: security of exchange, sanctity of contract and freedom of contract.

[141]Ramesh convincingly highlighted the self-reinforcing nature of the 'legitimate expectations' argument. He noted that 'creditors' expectation that their investment will be undisturbed in a group insolvency is to some extent a mere reflection of the orthodoxy of separate legal personality.' He continued by underlining that more frequent incursions into the separate legal personality doctrine could further weaken the argument of legitimate expectations, used to justify separate (atomistical) treatment of group entities in insolvency. See Kannan Ramesh, 'Synthesising Synthetics: Lessons learnt from Collins & Aikman' *2nd Annual GRR Live New York* (26 September 2018).

proportionate to a legitimate goal.[142] In insolvency law, these goals or principles include, among others, optimal realisation of debtor's assets and rescue of viable businesses.[143]

6.1.2. Estate value maximization and restructuring of viable enterprises

This principle entails the achievement of the maximum value of assets, which shall ultimately 'facilitate higher distributions to creditors as a whole and reduce the burden of insolvency.'[144] Maximisation of insolvency estate can be achieved not only with the help of provisions on transaction avoidance and protection of rescue finance, but also through restrictions on the enforcement of cross-entity liability arrangements, which, as shown above, might otherwise accelerate the demise of a corporate group. Restructuring of financially distressed but viable enterprises is interlinked with the value maximisation goal. It rests on the premise that timely restructuring should reduce unnecessary liquidation and thus preserve businesses that are worth more as going concerns than if sold piecemeal. But to be worth saving or restructuring, there should be a restructuring surplus that can be fairly distributed among the stakeholders.

To distinguish which entities (or groups of entities) may be restructured and which need to be liquidated as soon as possible, the criterion of viability is often used in insolvency law. Viability is a complex concept, which may indicate competitiveness of the debtor's business model and good prospects for its post-restructuring survival. It also characterises businesses whose going concern value exceeds their liquidation value.[145] Economic viability, as contrasted with financial viability – the ability to repay debt obligations – is often established as an eligibility threshold or a filtering screen for restructuring proceedings.[146] This is based on the assumption that restructuring of

[142]The issue of contractual freedom and its boundaries in insolvency is the subject of a continuous academic debate. See Steven L. Schwarcz, 'Rethinking Freedom of Contract: A Bankruptcy Paradigm' (1999) 77 (3) Tex. L. Rev. 515, arguing that the fundamental policies underlying the US Bankruptcy Code, such as equality of distribution among creditors and debtor rehabilitation should in certain cases be able to limit contractual freedom. Jay L. Westbrook, 'Commercial Law and the Public Interest' (2015) 4 Penn. St. J.L. & Int'l Aff. 445, underlining the importance of protecting public interest in insolvency proceedings and concluding that the latter cannot be ensured when solely relying on creditors' contracting.

[143]Mevorach and Walters (n 104) 856, describing insolvency law as a unique sub-system of commercial law 'aiming to promote a fair process taking account of interests of multiple groups of stakeholders, to maximize value, minimize waste, and, enable rescue of viable businesses.'

[144]UNCITRAL Legislative Guide on Insolvency Law, Part one and two, 2004, Ch. I, para. 5.

[145]Lydia Tsioli, 'Evaluating the Policy Effectiveness of the Directive on Restructuring and Insolvency: a Question of the Framework's Scope?' in Jennifer L. L. Gant (ed), *Harmonisation of Insolvency and Restructuring Laws in the EU, Papers from the INSOL Europe Academic Forum Annual Conference Copenhagen, Denmark* (INSOL Europe 2020) 36. See also Matthias Kahl, 'Economic Distress, Financial Distress, and Dynamic Liquidation' (2002) 57(1) J. Finance 135, 141, arguing that '[v]iable firms should be continued because their continuation value is higher than their liquidation value.'

[146]The viability test may take different forms and can be applied at different stages of the process. For example, in the USA, viability is not checked at the start of Chapter 11, but it surfaces in norms on

non-viable enterprises leads to value destruction.[147] In this respect, the Restructuring Directive allows EU Member States to introduce a viability test as a prerequisite to accessing preventive restructuring procedures.[148]

If the business does not have prospects of financial rehabilitation and its going concern value is below liquidation value, the access to restructuring procedures and tools may be restricted. This equally applies to the availability of mechanisms seeking to curb the effects of cross-entity liability arrangements. Thus, if the debtor is economically unviable, as a general rule, its insolvency should not trigger the safeguards that limit the effects of cross-entity liability arrangements discussed in this paper, namely restriction of the operation of cross-entity ipso-facto clauses and extended enforcement stays. Needless to say, this should not preclude the affected and viable group members from initiating their own restructuring procedures and acquiring the insolvency-law-supplied protections.

6.2. The way forward

Section 2 examined various ex ante and ex post effects of cross-entity liability arrangements. While performing protective, risk control and risk mitigation functions, potentially reducing the agency cost of debt for a guaranteed creditor, these arrangements may also be used opportunistically, disadvantaging non-guaranteed creditors (thus increasing the agency cost of debt), encouraging holdouts and disincentivizing early crisis responses. Based on the analysis of national and regional law responses (Sections 4 and 5) and relying on the principles at play (sub-section 6.1.), this sub-section advances some recommendations which can help ensure a balanced approach to cross-liability arrangements in group restructurings, enhance the existing legal regimes and serve as a basis for future harmonisation attempts.

6.2.1. Restriction of cross-entity ipso facto clauses

Ipso-facto clauses are expressly restricted or completely prohibited in the USA, France, Greece, Denmark, Canada, Australia, Austria, the UAE, Spain,[149] and recently, in Germany, the UK and the Netherlands. The reason behind this limitation of contractual freedom relates to the detrimental effects that ipso facto clauses can have on restructuring, since the

involuntary conversion and dismissal (11 U.S.C. § 1112) and relief from the stay (11 U.S.C. § 362). In the UK, as a part of a new moratorium procedure, a monitor should at the outset assess and state that it is likely that the moratorium would result in the rescue of company as a going concern. See Insolvency Act 1986, Part A1, A(1)(e).

[147]Horst Eidenmüller, 'Contracting for a European Insolvency Regime' (2017) 18 EBOR 273, 288, emphasizing the filtering function of insolvency law, which should be available 'to restructure only viable firms and liquidate the non-viable ones.' Eidenmüller also notes that the 'economic costs resulting from this mistake [letting non-viable firms to restructure] are surely not trivial.'

[148]Restructuring Directive, Article 4(3).

[149]Chuah and Vaccari (n 73) para. 1.43.

resulting acceleration or termination of contracts may facilitate liquidation of viable enterprises. In other words, ipso facto clauses could result in the loss of value to the detriment of the principles of estate value maximisation and restructuring of economically viable enterprises.

It is sensible to embrace this justification and the underlying rationale to restrict the effects of ipso facto clauses in an enterprise group context. Meanwhile, this same justification should act as a restraint on unnecessary or overreaching encroachment on freedom of contract. This approach is inherently principle-based and functional. It focuses on the functions of the existing or conceived rules and interprets them through the prism of legal principles. Dworkin noted that legal principles have the 'dimension of weight and importance',[150] and therefore they must be balanced and measured against the facts of a specific case and the different interests involved.[151] Based on this analysis, and in pursuit of a balanced solution, the following recommendations regarding cross-entity ipso facto clauses can be made.

Firstly, the restrictions on cross-entity ipso-facto clauses are only justified if their application endangers the debtor's financial position. Hence, such restrictions should only apply if the debtor is in financial distress or would become financially distressed because of the contract termination or acceleration due to a cross-entity ipso facto clause (Scenario 3, sub-section 4.2.). This recommendation is premised on the understanding that it is insolvency law and its apparatus (broadly construed) which give a theoretical justification to affect contractual rights.[152] Without an insolvency risk for the relevant affiliate, this justification is simply gone.

Secondly, in order to contain the encroachment on freedom of contract and parties' legitimate expectations, the unenforceability of cross-entity ipso facto clauses may be limited to specific contracts. For example, the limitation could apply to (i) contracts imposing obligations which are guaranteed or supported by another group entity (cross-guarantees, cross-collateralization, intra-group loans), or to (ii) contracts with intercompany cross-default provisions. This suggestion follows the BRRD's approach (sub-section 4.3.3. above). The reason for targeting these contracts is that they signal the interrelatedness of the group's business ('integrated enterprise') and could instigate the spread of contagion. They may also be viewed as creating an expectation that the transacting party is the entire group and that it should be restructured as such. The latter is crucial to address the legitimate expectations concerns.

[150] Ronald M. Dworkin, 'The Model of Rules' (1967) 35 U Chi L Rev 14, 27.
[151] Bork (n 139) para. 1.33.
[152] Jay L. Westbrook, 'A Functional Analysis of Executory Contracts' (1989) 74 Minn. L. Rev. 227, 228, writing that insolvency 'is that volume of the law that might have been written by Lewis Carroll, every conventional legal principle refracted through the prism of insolvency.'

Thirdly, the limitation of ipso-facto clauses is sound where it pursues the goal of maintaining and increasing the value of the debtor and of its affiliates. Thus, where the debtor and the affected group entities are non-viable and therefore their liquidation value exceeds the going concern value and no restructuring surplus is expected, restrictions on ipso-facto clauses are undesirable. In such a case, enforceability of ipso facto clauses may actually prompt timely liquidation of non-viable firms, thereby preventing the acceleration and accumulation of losses to the detriment of creditors. Arguably, identification of viable firms and enterprise groups is a difficult task that may be performed at different stages of the process. I suggest that the entity seeking to benefit from the limitation of a cross-entity ipso facto clause should bear the burden of proving its own viability, whether in the restructuring proceeding of the primary debtor or in a separate proceeding.

6.2.2. Extension of enforcement stays

The previous sections have shown that the protective shield of an enforcement stay may need to be extended to the debtor's affiliates to achieve the efficient restructuring of the group, preserve group synergies and maintain operational continuity of group entities. However, the extension of a stay to protect third parties must pursue a legitimate goal and provide sufficient safeguards to avoid abuse. Having this in mind, the following recommendations can be suggested.

Firstly, the extension of a stay to third parties, including group entities, should not be automatic, since such parties are not themselves subject to insolvency proceedings and therefore should not automatically benefit from insolvency law protections. For example, a subsidiary liable under a cross-guarantee should not enjoy the protection of an automatic stay just because it is a subsidiary of a parent company that has initiated a restructuring procedure. Any other interpretation would go too far in limiting individual creditors' rights and unduly restricting the 'protective function' of intragroup guarantees and other forms of cross-liability arrangements mentioned in sub-section 2.2.

Secondly, enforcement actions against a debtor's affiliate should not be enjoined where such actions are not likely to jeopardise or frustrate restructuring attempts of the debtor and where they do not disrupt the debtor's business during negotiations with creditors. This may be the case where the enterprise group is not integrated or where the affiliate is solvent, and creditor's actions do not undermine its solvency. The opposite scenario occurs where the group is interdependent and interconnected and the affiliate plays a necessary and integral part in debtor's restructuring,[153]

[153]The concept of a group member 'likely to be a necessary and integral participant' in the resolution of enterprise group's (or a part of the enterprise group's) financial difficulties, has been introduced in the MLEGI. Thus, a planning proceeding – one of the major innovations of the MLEGI – can only be

which suffers as a result of actions against the related company. In this latter case, a guaranteed creditor could take a holdout position and act opportunistically. Hence, the extended stay should be warranted.

Thirdly, guided by the same logic and principles as the deactivation of cross-entity ipso facto clauses (see sub-section 6.2.1), the extension of a stay should be available only to economically viable companies. If the debtor is unviable, the extension of a stay to third parties will not be able to bring it to economic viability or increase its insolvency estate value beyond the liquidation value. In a situation like this, the normative basis for the extension of a stay may be lacking. If a third party (e.g. guarantor, co-debtor, collateral provider) is viable, its rights can still be protected through a separate insolvency or restructuring proceeding. The opening of such a proceeding should make it easier to assess the viability of a third party and offer safeguards against abuse.[154]

Fourthly, and finally, a restraint of an enforcement action against a third party should not unfairly prejudice rights of the guaranteed creditor or cause substantial detriment to it. This may be the case where the collateral, held by the debtor's affiliate, significantly depreciates in value during a stay or where the guaranteed creditor's claim is made worse-off, or if a stay leads to uncompensated loss. This can happen in a situation where the debtor or the third party engage in opportunistic value-destroying behaviour or misconduct, such as the strategic stripping of assets from the guarantor or co-debtor out of the creditor's reach and to the detriment of a guaranteed creditor. In this case, an extension of a stay should be immediately terminated or declined in the first place.

7. Conclusion

This article focuses on the problems created by the proliferation of cross-entity liability arrangements, including intra-group guarantees and cross-entity ipso facto clauses. It is important to emphasise that whereas their enforcement can be individually rational, it may prove disastrous on a collective or group level. The very normative foundation of insolvency law is centred around the idea of limiting individual freedom for the benefit of

opened with respect to an entity that satisfies the requirement of being a 'necessary and integral participant' in a group solution. MLEGI, Article 2(g)(ii). The Guide to the MLEGI in para. 46 explains that it should be apparent that the sought restructuring could not be developed and implemented without involvement of that particular group entity. This characterisation can be instrumental in determining whether a group entity should have access to an extended stay, as suggested in this paper.

[154]See *In re Metromedia Fiber Network, Inc.*, 21 July 2005, 416 F.3d 136 (2nd Cir. 2005). This case concerned a related concept of a third-party release. The court warned that 'a nondebtor release is a device that lends itself to abuse. […] In form, it is a release; in effect, it may operate as a bankruptcy discharge arranged without a filing and without the safeguards of the Code.' While the extension of a stay does not go as far to discharge the debt, it can have important consequences for a guaranteed creditor.

creditors as a class and also in the public interest.[155] The problem is that such limits almost exclusively apply on an individual company basis, largely ignoring group interdependencies and the role of group entities which are not subject to the collective mandate of insolvency law.

I have examined the ex ante and ex post effects of cross-entity liability arrangements, focusing on their economic rationale and the impact on the agency cost of debt and access to finance, managerial behaviour, as well as the position and rights of guaranteed (secured) and non-guaranteed (unsecured) creditors. These arrangements could serve important protective, risk-reduction and risk-management functions. However, in a situation of financial distress, they can contribute to the spread of contagion across the group, promote holdout behaviour and disincentivize debtors from taking preventive steps to avoid insolvency. These features become especially visible in the light of the emerging trend towards rescue of financially distressed but economically viable enterprises and a gradual appearance of rules in national law and international soft law instruments targeting the insolvency of enterprise groups.

Countries around the globe are experimenting and searching for effective mechanisms to promote group restructurings. This search has resulted in provisions restricting the application of (cross-entity) ipso facto clauses and extending an enforcement stay to affiliated companies, with a view to safeguarding group synergies and preserving the debtor's going concern value as well as the chances for successful restructuring.

As the debate continues, this paper has taken a principle-based and functional approach to develop guidelines and recommendations, which can help find a balanced solution to cross-entity liability arrangements in group restructurings, enhance the existing legal regimes and support future insolvency law reforms and harmonisation attempts. The recommendations suggested above seek to protect creditors' legitimate expectations, preserve and maximise insolvency estate value, discourage abuse (e.g. through the access of non-viable firms) and encourage efficient group-mindful restructuring of enterprise groups.

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[155]Thomas H. Jackson, 'Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain' (1982) 91 Yale L.J. 857, 862. Harry Rajak, *Insolvency Law: Theory and Practice* (Sweet & Maxwell 1993) 86.

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Appendices

Appendix 1

Restriction of ipso facto clauses

Jurisdiction	Year	Law
USA	1978	11 U.S. Code Title 11, § 365(e)
Canada	1992, 2005, 2007[156]	Bankruptcy and Insolvency Act (BIA), sec. 65.1, 66.34, and 84.2; Companies' Creditors Arrangement Act (CCAA), sec. 34
Mexico	2000	Commercial Insolvency Law (*Ley de Concursos Mercantiles*), Article 87
France	2005	Commercial Code (*Code de commerce*), Article L. 622-13
Austria	2010	Insolvency Act (*Insolvenzordnung*), § 25b(2)
EU	2014	Bank Recovery and Resolution Directive, Article 68
Australia	2018	Corporations Act 2001, sec. 415D
Singapore	2018	Insolvency, Restructuring and Dissolution Act 2018, sec. 440
EU	2019	Restructuring Directive, Article 7(5)
UK	2020	Corporate Insolvency and Governance Act 2020, adding sec. 223B to the Insolvency Act 1986
Netherlands	2020 (in force since 1 January 2021)	Act on Court Confirmation of Extrajudicial Restructuring Plans (WHOA), Article 373(3)
Germany	2020 (in force since 1 January 2021)	Enterprise Stabilization and Restructuring Act (StaRUG), Sec. 44

[156]The relevant provisions invalidating ipso facto clauses were adopted gradually. Adrienne Ho, 'The Treatment of Ipso Facto Clauses in Canada' (2015) 61 McGill L.J. 139.

Appendix 2

Extension of a stay to third parties

	USA	Singapore	The Netherlands (WHOA)
Is the extension of a stay to third parties available?	Available in exceptional circumstances	Available in restructuring (schemes of arrangement)	Available in restructuring (extrajudicial restructuring plans)
Who can request the extension of a stay?	Debtor and a third party	Related company	Debtor or restructuring expert (if appointed)
Who can benefit from the extension of a stay?	Broad category of legal entities and persons (e.g. group entities, officers-natural persons, insurance companies)	Debtor's subsidiary, holding company or ultimate holding company	Group entities which have secured the obligation of the debtor (guarantor, collateral provider, co-debtor)
What are the requirements for the extension of a stay?	Different considerations, including: (i) identity between the debtor and a third party; (ii) a claim against a third party has an immediate adverse effect on debtor's estate; (iii) stay is essential to debtor's reorganisation efforts	A related company plays a necessary and integral role in debtor's restructuring and such restructuring is undermined if actions are taken against the related company. No creditor should be unfairly prejudiced by a stay	A restructuring plan shall entail the amendment of creditors' rights against the related company, this company should be in financial distress, it should give its consent and the court should have jurisdiction over it